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VOLUME 9 **ISSUE 21**

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Money isn't everything, but fiscal stringency is having considerable impact on state policies in most fields of state activity. One result has been to deter implementation of new initiatives in education, health care, and other areas. When state money is tight, education seems to be the disproportionate loser.

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THE BUDGET PICTURE

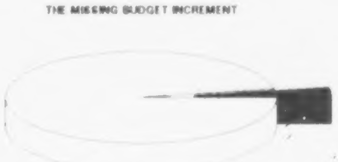
Money Isn't Everything, But ...

This year state and local governments will be spending about $4,100 per capita, $12,000 for a family of three. That isn't small change.

If the economy had performed better during 1991, state and local governments might have spent $40-100 more per capita. Next year, perhaps a sluggish economy will take another $40-100 of what spending could have been. That isn't small change either, but illustrates the relatively small amounts at stake in incremental changes in state and local budgets.

Nonetheless, current state fiscal problems (Issue 20) are having major impacts on state policies in many fields. The coverage of current state developments in this issue is organized around those impacts. The impacts on state policies and on the public are much greater than the state revenue lost to the economic downturn. While large in dollar terms, $10 billion or so, it is a small piece of total state government spending as illustrated below.

Lack of new money cuts off policies that would involve states paying for activities not now in their portfolio. This precludes such initiatives as becoming a major force in subsidizing low income housing, providing expensive initiatives to broaden private health care coverage, and expanding welfare cash assistance to the near poor.



But does it necessarily cut off initiatives that aren't inherently expensive, such as altering how schools are managed or shifting recipients of welfare into the working world? Those questions are producing debate in many state capitols. So is the eternal question of whether money can be found for new initiatives by cutting low priority programs. Those questions will be particularly salient in late 1991 as many elected officials are desperate to avoid pre-election tax increases.

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The Budget Picture Isn't Bright

The financial status of the states was precarious going into the current fiscal year (FY 1992). It will remain precarious coming out of it, according to the official figures of state executive and legislative budget agencies as reported in the fiscal surveys of the National Association of State Budget Officers (NASBO) and the National Conference of State Legislatures (NCSL). The key figures from the two surveys are shown in Table 1.

Table 1: Summary Financial Statistics From Two Recent Surveys ($ billion)

Category	NCSL	NASBO
Spending, FY 1991	$283.9	$287.2
Spending, FY 1992	$297.8	$301.5
Percent Increase in Spending	4.9%	5.0%
Balances At End FY 1992	$2.1	$4.1
Balances Plus Rainy Day Funds As Percent Of Spending	2.0%	1.9%

Both surveys reflect spending increases of roughly the expected rate of inflation. Revenues are slated to rise somewhat faster, reflecting tax increases and a need to rebuild balances. With spending overall only growing to match inflation, with Medicaid and corrections growing faster than inflation, and debt service growing in many states, many other programs will see increases below the inflation rate. New initiatives that cost money are understandably scarce.

Economic recovery, which is not a sure thing, could improve the outlook in FY 1993. But the environment for new initiatives won't improve much. The combination of the problems of FY 1991 and the problems developing this year means most states will be carrying a full load of fiscal baggage into FY 1993. This load will have a high priority claim on available resources. The baggage includes: (1) temporary taxes scheduled to expire, (2) one-time revenue items requiring spending cuts unless other one-time items can be found, (3) unpaid loans to other state funds, (4) payments in arrears to local governments, vendors, and state employees, and (5) deferrals of outlays for equipment, promotions, major maintenance, and capital outlays.

In short, those interested in major new initiatives from the states need to be interested in the prospects for tax increases in most state situations. Conversely, those interested in avoiding tax increases need to be interested in the new initiatives, as well as the continuing costs, that might seem to require them.

Voters And Taxes

November 5 will go down as a day the whole country will remember.
It sent the message ... people want less taxes and less government.

This was the post-election comment of Chuck Haytaian who will become the new speaker of the New Jersey House in January when Democratic majorities in both Houses are replaced by veto-proof Republican majorities. This was one of the biggest one-year partisan turnarounds in history. The Republicans campaigned against the 1990 tax increases and Governor Florio's record to unseat Democrats who were supportive of the governor on tax policy, auto insurance reform, and other issues.

The New Jersey Message: A strong case can be made that the New Jersey vote *does not* carry any implications outside New Jersey because of unique factors there. But the operative question is not whether objectively New Jersey is unique but rather whether legislators in other states think it is unique.

The New Jersey tax increase wasn't as easy to sell voters as others around the nation. First, many voters read candidate Florio as pledging no new taxes in November of 1989 and proposing a whopping tax increase several months later. Second, the 1989 campaign promised an intensive effort through task forces to find savings in existing spending patterns. The savings effort really didn't get underway until after the tax increase was being pushed and hasn't produced any well-publicized savings.

Third, taxpayers never understood the complex link -- the school aid formula -- between state tax increases and promised local property tax relief. Fourth, the tax measure became and stayed a highly partisan issue -- much more than in other tax-raising states like California and Pennsylvania. Fifth, the measure and the process of its enactment alienated some groups usually supportive of such measures, particularly teachers. Sixth, attempts to patch the 1990 legislation created more political problems as the state took a tough line in its labor negotiations and withdrew some of the previously enacted education aid.

The Missouri Message: A less ambiguous signal was sent by the 622,468 Missouri citizens who said no to the tax increases (sales, personal income, corporate income, tobacco) and education funding measures on the November ballot. The 303,653 citizens voting yes were only about a third of the vote. By just about any measure, Missouri is one of the lowest spending states in the nation. The tax increase was endorsed by the Republican governor, Democratic legislative leaders, and interest groups of many kinds. Proponents outspent opponents by a wide margin.

There isn't a long list of special circumstances to explain the lopsided vote. One may have been the running dispute between state officials and a federal district judge that received considerable publicity just before the election. The case has been drawing state tax funds from the rest of the state to support a Kansas City school system that is considerably more expensive and arguably less well managed than others. Just before the election, the governor announced that aid to other school districts would have to be reduced to cover the costs of a new court order requiring the state to pay for the district's extensive construction program.

Legislators Look At Taxes

Another factor affecting whether taxes will be raised to pay for current and possible new state programs is legislators' attitudes. They can't be quantified, so readers must rely heavily on their own observations. It appears that candidates for local and state office this year stressed more than usual their objections to taxes and spending levels.

Whether the 1991 elections show a change in the intensity of opposition to state tax increases or not is debatable. What isn't debatable is the intensity of opposition already. "Just say no" to new taxes has already had a major impact on state spending patterns.

Pressures For Tax Increases Next Year

This year many states didn't raise taxes or raised only minor levies by minor amounts. Some avoided tax increases because they could make spending on current services more or less conform to the revenues available from current taxes. Such states, along with states that made major increases in 1991, may well avoid tax increases in 1992. With economic recovery, some other states could fund current services without tax increases in 1992. But some couldn't without significant spending cuts. The list of states needing major tax increases or major spending cutbacks in 1992 is debatable, but looks something like this:

Colorado
Iowa
Mississippi
Virginia
Georgia
Kansas
South Carolina
West Virginia
Wyoming
Indiana
Michigan
Tennessee
Wisconsin

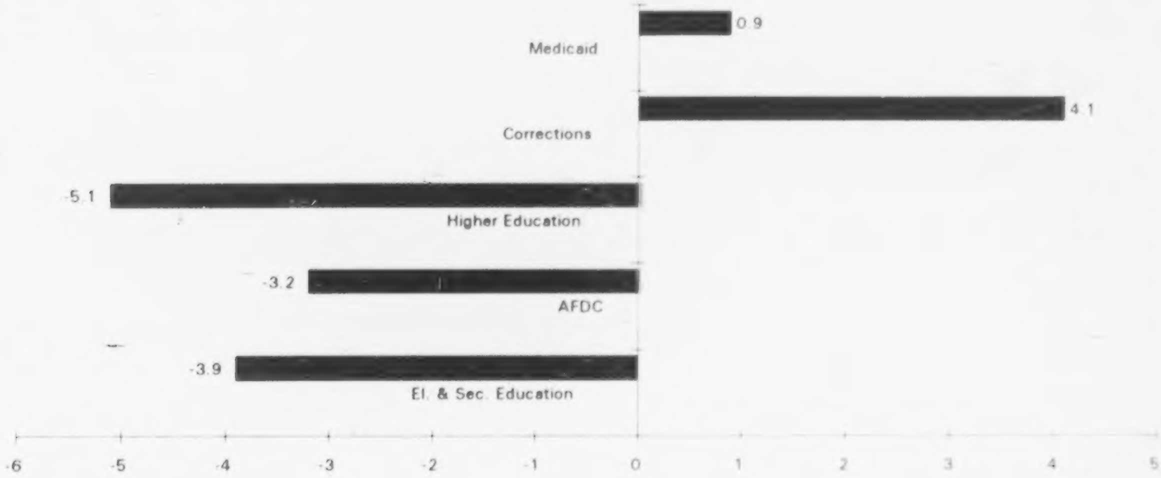
Officials of these and other states will face the tax issue again in 1992, along with officials in states like California and New York where this year's budget-balancing measures appear to have fallen short.

In its new **TaxWatch**, State Budget & Tax News (Issue 21) predicts that some are likely to raise taxes. But whether they do and the consequences of holding the line will be key issues in the next sessions. Colorado's special session this fall was a preview of the action.

Who Loses In Austere Times?

When budgets are tight and tax increases aren't an option, programs get squeezed. This squeeze is most traumatic when it occurs after a budget has been enacted. Procedures vary by state on whether the governor or the legislature has authority to make the cuts, but every state has a mechanism to withhold spending of appropriations already made. While sometimes announced as across-the-board cuts, most of these cuts have had quite unequal impacts. The chart shows what happened to spending in FY 1991 after appropriations were approved.

Percentage Gain (Loss) In FY 1991 Budget Adjustments



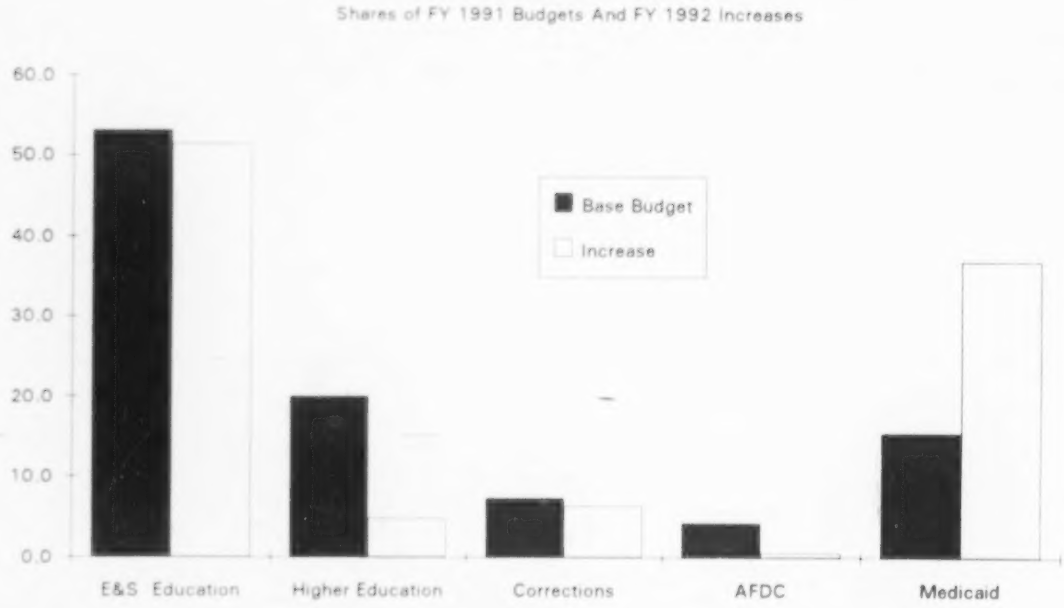
While there are some problems in compiling these figures as explained in the Technical Appendix, the chart correctly portrays an unequal outcome among programs. Medicaid and corrections got substantially more money in FY 1991 than in the budgets originally approved for them.

Where did the money come from? It didn't come from unexpected revenues because revenues in FY 1991 were lower than anticipated when budgets were passed. So it came: (1) from the mid-year cuts in education and AFDC shown in the chart, (2) from tax increases, and (3) from running down balances which ultimately will be replenished at the expense of other programs and the taxpayers.

Who Loses This Year?

The dramatic mid-year adjustments made in FY 1991, as shown on the chart above, mean that the enacted FY 1992 budgets need to be taken as less a blueprint for spending and more as a hint of spending decisions to come. If past patterns are followed, Medicaid and corrections will exceed budgeted increases.

Even before the mid-year adjustments are made, the enacted budgets reported by legislative fiscal officers indicate major changes in priorities. The chart below compares the FY 1991 percentage shares that five major programs took of the total for the five of them and, in the second bar, the shares they took of the increases voted for FY 1992.



This shows that in the budget battles earlier this year elementary and secondary education held its own with about half of general fund spending for the five programs shown and half of the increases. Medicaid made a major gain at the expense of the other programs, particularly higher education. While corrections and AFDC may recoup their losses through supplemental appropriations, higher education will not. Because spending patterns for the 1991-1992 academic year have been set based on approved state budgets, the need for supplemental appropriations to finish the year doesn't arise.

The chart deals only with shares of appropriations for the five programs. The biggest losers of all were those not reported separately. The appropriations ~~for~~ the "all other" category were actually reduced. Particularly vulnerable items in this category have been: (1) capital outlays funded out of general revenue, (2) unrestricted aid to local government, and (3) general fund spending for programs often funded out of special funds such as transit, highways, and regulatory activities.

HEALTH CARE

Interest Grows In Health Care Solutions

If criminals have a right to a lawyer, I think working Americans should have a right to a doctor.

This was one of Pennsylvania Senator Harris Wofford's standard one-liners. Journalists, political analysts and pollsters suggest that his emphasis on health care was a major reason for his upset victory over former Governor Thornburgh. The perception that health care has become a highly significant issue to the American voter appears to be increasing the willingness of federal and state elected officials to offer proposals to deal with the subject.

The prospects for federal-state conflict are great. Many state officials prefer that the subject be handled primarily by a nationwide plan, such as some form of national health insurance. Even those preferring less comprehensive federal roles need federal approvals for actions such as: (1) waiving Medicaid rules to permit state experiments like Oregon's, (2) altering the Employee Retirement Income Security Act to permit states to regulate collectively bargained health plans as Hawaii does, and/or (3) providing for state flexibility in regulating providers as California seeks. Federal officials seeking to act are considering altering state policies by preemption of regulatory authority over health insurance plans, mandates in the Medicaid program, and preemption of state tort laws.

New Federal Proposals Appear

The Bush Administration position is that major health care reform should wait until after the 1992 elections. No specific proposals are on the table, though the President has indicated he will be addressing health care solutions in the 1992 campaign.

Some key Democratic Congressional leaders are pressing for at least some action on a faster schedule. The stalking horse is legislation offered in late October by Senator Bentsen and Representative Rostenkowski, chairmen of the key financial committees of the Senate and House. The legislation is designed to preempt the states in many aspects of health insurance regulation. The enforcement mechanism is indirect. If insurance companies don't comply, they would be subject to special federal taxes.

The legislation wouldn't put new money into health care with a limited exception. Corporations can now deduct money spent on health insurance for employees, but self-employed persons can only deduct a part. The bills would make this treatment comparable.

With that exception, the benefits of the legislation to some firms and their employees would have to be costs to other firms and employees. This leads to the same problem that states face in insurance regulation of all types. The costs of insurance for high risk persons, such as individuals with difficult medical conditions or drivers with long accident records, is often more than they can reasonably be expected to pay. But others also find insurance expensive to the point where many don't carry it. The high cost rates can be cut by increasing the regular cost rates -- a controversial step for the states and for the federal government.

A state agenda for federal action was presented by National Governors' Association Executive Director Raymond Scheppach in Congressional testimony in late October. As adopted by the governors this summer, it includes new federal programs for dealing with the uninsured, as well as relaxation of some federal rules to allow greater state experimentation.

It is unlikely that any of the major proposals for federal legislation will be adopted before state legislatures meet next year. This will leave state officials in a position of uncertainty about future federal policy as they attempt to fashion state-level solutions. This, of course, isn't a new situation.

New State Proposals Appear

There has already been heavy state activity on the insurance coverage issues addressed by the Democratic leaders in Congress. State Health Notes (10/7) counts 15 states acting this year on such issues as guaranteeing policy renewal, limiting premium increases, and guaranteeing availability of insurance to small business.

Most legislatures aren't in session now, but Michigan's is -- with health care a major topic. Its Senate recently passed a major package. In general, Democratic legislators around the country have been more comfortable with extensive state involvement in comprehensive health care plans than Republicans. The Michigan legislation is indicative of those alternatives being considered in the states that don't involve substantial budget outlays (but do involve substantial costs). Don't look for immediate enactment even though the legislation passed the Senate. It is common in Michigan for the Senate Republican majority to pass legislation on major topics and the House Democratic majority to pass different legislation on the same topics, with no legislation ever enacted.

The Michigan bills provide for substantial tax credits to encourage purchase of basic health insurance coverage. Credits would go to businesses with extraordinary health insurance costs and to companies that become first-time buyers of employee health insurance. Blue Cross/Blue Shield would be required to offer a basic plan to individuals at a price of about $120 a month for family coverage bought through a group ($180 for individually purchased policies). Losses from these policies would presumably be spread over other Blue Cross customers. In addition, the purchasers' costs would be reduced by personal tax credits of up to $60 a month.

For children who didn't obtain coverage by any other mechanism, the state would provide coverage in the Blues' minimum plan. That cost, estimated at $40 million, would come from somewhere in the unsubsidized component of health insurance. Sponsors mentioned using the component of reimbursements for hospitals associated with capital outlays. There is also a provision to restrict medical liability and thus reduce the malpractice insurance component of health costs.

Bootstrap Financing Still At Risk

The issue of using voluntary contributions and provider taxes to finance the state share of Medicaid has now drawn attention commensurate with its significance for both health care and the condition of state budgets.

Compromise negotiations between state and Administration officials are underway. They contemplate significant restrictions on what some states are doing, including: (1) eliminating voluntary contributions, (2) restricting provider taxes, particularly those tied to how much providers get from Medicaid, and (3) limiting how states handle "disproportionate share" financing of hospitals serving large proportions of low income patients. By "grandfathering" some current state plans and transition provisions, the compromises would avoid the sharp mid-year effect on some FY 1992 state budgets that would occur if regulations offered earlier this year were allowed to go into effect as drafted.

With no compromise, the range of outcomes is bracketed by the current draft of the regulations and the proposed Congressional action, the Medicaid Moratorium Amendments of 1991. The moratorium bill would block new adoptions of voluntary contributions and phase out existing uses while protecting provider taxes through the fall of 1992. The regulations would theoretically go into effect in January, but contain a provision that would permit all states to continue most current practices through June.

The net effect of all alternatives will be to force some states to drop some Medicaid financing mechanisms they now use. The issues are how many and when. The effect is that some states will have to act in early 1992 to find new methods of financing part of their Medicaid costs.

Even as this activity is occurring at the federal level, states are relying more on bootstrap financing. Plans adopted by some states in their FY 1992 budgets are being implemented and some states (e.g., New Hampshire and West Virginia) are holding special sessions to adopt plans.

Reimbursement Rates Rise Under Legal Pressure

Major increases are being made in state Medicaid reimbursements to health care providers as they flex new legal power to force states to pay more.

Providers -- hospitals, nursing homes, doctors, pharmacists, and others -- have been contending for decades that states don't pay them enough for Medicaid services. Short of refusing to accept Medicaid patients, their redress was in the legislative and administrative forums of the states. In a case decided last summer, the U.S. Supreme Court considered a Reconstruction Era civil rights statute, along with the federal Medicaid statute indicating reimbursement should be "reasonable and adequate," to find providers had standing to bring suits against states over rates.

The result has been a rash of litigation. By one count, suits have been filed by hospitals in 21 states and by nursing homes in 20. But the count doesn't matter. The threat of litigation is a factor in negotiations even where no suit has actually been filed. And filing a suit is sometimes a step in seeking a negotiated rate, not a determination to obtain a judicially set rate.

"Reasonable and adequate" isn't a precise standard and there are few cases to define it. So negotiated settlements are common even in advanced stages of litigation. This is what happened in Washington where a negotiated settlement was developed after a U. S. district court decision supporting the hospitals' position. The result is a 10% increase in rates. If other states incurred the same per capita costs, the decision means about $3.2 billion annually in added costs, of which about $1.4 billion would be state funds and the rest federal. Adding in similar settlements for other providers, particularly nursing homes, raises the ante further.

How Much Pressure Will Medicaid Put On State Budgets?

> *Medicaid was a chief culprit on the spending side that contributed to states' overall budget dilemmas.*

This comment in the NCSL fiscal survey describes Medicaid as a source of current fiscal problems. It may be the source of future fiscal problems as well, as many state budgets apparently don't anticipate the costs likely to be incurred. NCSL itself calls sticking to FY 1992 budget plans "a near impossibility." It continues by noting the 21.8% increase budgeted by the states "may underestimate what amount states will actually spend on Medicaid."

The real costs of Medicaid are determined by such factors as how many people are eligible, what services are provided to those people, and what reimbursement rates are used to determine how much to pay for those services. But the budgetary impact of Medicaid in any particular year is determined both by those factors and by decisions on how much to appropriate for Medicaid, when to appropriate, and how to account for certain aspects of Medicaid spending.

These arcane topics have had substantial impacts on the fiscal outcomes in the states, including impacts on spending for other programs and on the perceived need for increases in state taxes. The impacts of past decisions on how to treat Medicaid in the budget (as distinct from how to treat it in the real world) are still appearing. They are a part of the reasons for recent shortfall announcements in California and New York. Their consequences now appear in the debt service costs of Massachusetts government. Their consequences will soon appear in discovery that the balanced budget recently adopted by the Michigan legislature isn't balanced.

The Hidden Medicaid Budget

Serious Accuracy Problems: The rapid escalation of Medicaid costs has brought out some of the least attractive aspects of state budgeting processes. The amounts appropriated have not corresponded to the amounts spent or, in many states, even been close.

This may be an indictment of the accuracy of state estimating procedures, with errors that far exceed what are considered acceptable when comparable deviations between estimated amounts and actual amounts appear in revenue estimating. It may also indicate a lack of candor by state officials who are reluctant to show the degree to which they are allowing other programs to be squeezed by Medicaid and the extent to which tax increases are required because of Medicaid cost increases.

Timing Of Spending: In some states, the Medicaid spending numbers are indicative of the potentials for distortions of financial reporting to occur when cash rather than accrual accounting is used *and* payment practices are changed to deal with budget problems. In normal circumstances, Medicaid bills of, say, $100 million a month would be incurred by patients using health services and $100 million a month would be paid about two months after services were rendered. Cash and accrual accounting systems would both report an outlay of $100 million for the month. The cash system would be reporting bills when paid and the accrual system would be reporting bills when incurred, but the reported costs would be about the same.

But suppose the state decides not to pay during a particular month, lengthening the billing cycle to 90 days from 60 days. Under accrual accounting, the expense for the month is still $100 million, but under cash accounting, the expense is zero. When catch-up occurs, the cash system would report a double outlay of $200 million while the accrual system would still report $100 million. What works for a month works for a year, so apparent costs can be reduced by one twelfth by skipping a month of bill paying.

When the practice is not fully disclosed (or the significance of obscure disclosures not understood), it can lead to persistent imbalance in state budgets and ultimately to tax increases. This is a major part of the West Virginia fiscal story in the late 1980s and the Massachusetts fiscal story from 1988 through 1990.

Use Of Special Funds: Medicaid also illustrates the impact on financial reporting when multiple state funds support a single activity. Some states are apparently taking provider donations and other bootstrap financing money into special funds, rather than the general fund. As a result, the sharp increase in funding from these sources won't appear in general fund budget totals. In NASBO's reporting on FY 1991 spending, state general fund spending for Medicaid increased by 17.2% but the much smaller category of other fund support of Medicaid grew by 125%.

Wide Differences Between Budgeted Amounts And Spending: All of these difficulties in accurate reporting -- and thus in understanding by elected officials, lobbyists, and the public -- appear in the statistics shown on Table 2.

Table 2: Percentage Increases In FY 1991 Medicaid Spending

State	Budgeted	Actual	Supplemental
Relatively Normal Patterns			
California	14.1%	21.0%	7.0%
Texas	14.7	27.9	13.2
Ohio	8.9	20.7	11.8
Michigan	-2.3	13.5	15.9
New Jersey	13.7	30.7	17.0
Virginia	19.1	28.6	9.5
Indiana	24.5	22.3	-2.2
SEVEN STATES, Average	13.2	23.5	10.3
Spending Below Appropriations			
UNITED STATES, Total	13.8	9.9	-3.8
Florida	60.3	48.7	-11.6
Georgia	34.0	27.9	-6.1
New York	11.8	-8.8	-20.6
Illinois	6.4	-42.0	-48.4
Unlikely Spending Increases			
Missouri	11.7	35.2	23.5
North Carolina	19.1	69.0	49.9
Pennsylvania	4.3	59.0	54.7
Unwilling To Report			
Massachusetts	21.9	n/a	n/a

Table 2 is based on legislative fiscal officers' reports to NCSL for its annual fiscal survey. **Reports** compared three figures from the largest 15 states, which have two-thirds of the nation's population: (1) what was spent for Medicaid in FY 1990, (2) what was approved in the FY 1991 budgets for Medicaid as reported last October, and (3) what was actually spent as reported this October. The results are shown as percentage changes. For example, California budgeted for a 14.1% increase but finished the year with 21% higher spending, requiring supplemental appropriations authority of 7%.

The results are literally incredible, in the sense of not being believable.

The gap between estimated increases and actual increases was more like a chasm. The average deviation between predicted and actual increases was 21% -- like estimating a 10% increase and getting an 11% cut or a 31% increase. By contrast, estimating errors of 2% or less are common in revenue estimating and a large error, like failing to predict a recession, would be in the 4-8% range at most. The chasm has three components contributing in unknown proportions but all producing less than complete accuracy: (1) misestimates of caseload and cost, (2) deliberate misreporting, and (3) policy changes after the budgets were enacted.

Besides being large, the errors are in the wrong direction. State officials spent FY 1991 complaining about unanticipated costs, escalating provider charges, increasing caseloads, and unbearable mandates in Medicaid that increased their costs. Cost increases caused by these factors were cornerstones of complaints to the federal government about mandates, sharp cutbacks in other state spending, and tax increases. But as shown in the US total line on Table 2, the percentage increase nationally was less than originally budgeted.

The aberrations in individual states are large enough to affect what is reported as national totals. Medicaid costs are increasing in the 15-25% range nationwide with deviations above and below in individual states as shown in the seven states with relatively normal patterns. This range is reflected in state reports on actual spending and in the reimbursement claims states make for federal cost sharing. It isn't reflected in the national total shown on the table because the large negative growth numbers from some states drag down the national increase to 9.9%.

Underbudgeting For Medicaid: Table 2 tells many other stories, all significant for those interested in taxes and non-health programs such as education.

First, budgeting and reporting Medicaid spending exhibit many abnormal patterns. Seven states had normal patterns. Seven didn't. One (Massachusetts) didn't report at all.

Second, it is a normal pattern for Medicaid to be underbudgeted. In the seven "normal" states only 56% of spending was budgeted while 44% was left for supplemental appropriations. On an unweighted average basis, legislators and taxpayers of those states signed up for a 13% increase in Medicaid and wound up buying a 24% increase.

Third, there are interesting stories in the other states. The large negative for Illinois doesn't represent real savings but a deliberate decision to get through the 1990 legislative session without major tax increases by lengthening the Medicaid bill payment cycle. Total spending in the year drops for the same reason it would if a homeowner skipped a couple of mortgage payments. New York's decline probably is a smaller dose of the same medicine.

That Illinois would delay paying Medicaid bills in FY 1991 to lower spending and avoid a tax increase may not be laudable financial practice, but is understandable. But why would Missouri, North Carolina, and Pennsylvania increase their spending? One plausible reason is to get money for a cause perceived as not being popular out of the limelight by moving it from the new FY 1992 budget to the obscure FY 1991 supplemental budget. Each state adopted a tax increase for FY 1992. By shifting cost overruns in Medicaid to FY 1991, the tax increase could be discussed as being necessary for state programs across the board.

ELEMENTARY AND SECONDARY EDUCATION

Where Has All The Money Gone?

This wasn't a good year for the public schools. At least not if the measure is state money.

On the surface, the schools did well. The NCSL survey shows state budgets for elementary and secondary education for FY 1992 represent an increase of 8.9% over FY 1991. This is a much greater increase than the 4.9% for state budgets overall and clearly superior to the 2.2% increase for higher education. But there is much less in these numbers than initially meets the eye. Table 3 provides the state-by-state detail and suggests why.

While the national average increase beats inflation by a substantial margin, there are special explanations associated with the states making the large increases that take the average so high. They are indicated on the tables by symbols for tax increases ($) and special situations (*). Most of the states with large increases, those shown in the first column of Table 3, have one or the other.

Special situations are illustrated by Rhode Island and New Hampshire, both of which also had to increase taxes to enact balanced budgets and may, in the course of the year, have to curtail spending to maintain them. Rhode Island shows a dramatic jump in school spending between FY 1991 and FY 1992 because, as an austerity measure, it failed to make two of its 12 monthly school payments in FY 1991. Continuing deferral in FY 1992 would make 12 payments compared to 10, or a 20% increase. Catching up a month, which is the current plan, provides a 30% budgeted increase, but no real increase from the perspective of those interested in education.

New Hampshire has essentially eliminated its state school aid, leaving the schools primarily reliant on local taxes and whatever is available from dedicated lottery funds.

Table 3: Increase In State FY 1992 Elementary And Secondary Education Budgets

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Rhode Island $*	29.5%	17	Idaho	8.8%	34	Florida	3.4%
2	New Hampshire $*	28.7	18	Oregon	8.3	35	Colorado	3.3
3	California $*	21.9	19	Iowa	8.2	36	West Virginia	2.9
4	New Jersey $	21.8	20	North Dakota	7.5	37	Vermont	2.6
5	Hawaii*	18.7	21	New Mexico	6.6	38	Montana	1.4
6	Nevada $	18.7	22	Mississippi	6.2	39	Louisiana	1.3
7	Arkansas $	14.2	23	Indiana	5.9	40	Georgia	1.2
8	Maine $*	12.9	24	Michigan	5.8	41	Alaska	1.1
9	Nebraska $	12.3	25	Maryland	5.7	42	Missouri	0.5
10	Washington	11.1	26	Arizona	5.6	43	Alabama	0.4
11	New York*	10.1	27	Utah	5.4	44	Illinois	0.4
12	Ohio*	10.1	28	Wisconsin	5.3	45	South Carolina	0.3
13	Pennsylvania $	10.0	29	Wyoming	4.9	46	Kansas	-0.9
14	Oklahoma $	9.9	30	South Dakota	4.7	47	North Carolina	-1.2
15	Kentucky $	9.8	31	Connecticut $	4.6	48	Tennessee	-6.4
16	Texas $	9.2	32	Minnesota	4.1	49	Virginia	-6.4
	United States	8.9	33	Delaware	3.7		Massachusetts	n.a

Tax increases are illustrated both by states that increased taxes to maintain current spending patterns (e.g., California and Maine) and by the states that increased taxes this year or last year explicitly to increase education funding. This accounts for large increases in states such as New Jersey, Arkansas, and Oklahoma.

The Outlook For State School Funding

California's Proposition 98 expresses the minimum aspirations for state funding of those interested in schools in all states. First, they want to maintain "their share" of state budgets. In FY 1992 nationwide, this meant a 4.9% increase or more. By this test, adequate funding for schools was provided by 28 states as shown on Table 3. The second test is to cover current services defined as increases from the previous year for inflation and enrollment increases. Nationwide, that would be about 1% for enrollment and 4-5% for inflation. Enrollment change varies among the states from significant declines to increases of 3% or more. Probably about half the states met this test also. Proposition 98 requires state funding at a level sufficient to pass both tests.

Table 3 shows the close ties between economic growth, tax increases, and large increases in state aid. The large increases without tax increases were in states that have been substantially more prosperous than the rest of the nation, particularly the Northwest. The other large increases not associated with special situations (*) were in the states with large tax increases.

These close ties suggest how education funding is likely to fare for the next several years. In states with slow economic growth and no major tax increase, funding increases are likely to be at or below inflation as illustrated this year by nearly half the states. Faster state economic growth offers faster state revenue growth in which education will likely share in competition with other programs. But truly large funding gains depend upon the kinds of tax increases recently rejected by voters in Missouri and approved by voters in Oklahoma.

The Outlook For Education Quality Measures

In the practical political environment of the state capitols, there generally has been a close association between adoption of eduction quality measures and large infusions of state money into elementary and secondary education.

This tie has a clear base in reality where the state's quality measures include mandates of smaller class sizes, higher teacher pay, and new programs for pre-kindergarten youngsters. These quality measures are clearly costly.

The tie is more political than economic when the state mandates deal with such issues as student and teacher testing, teacher tenure, and relative power of teachers, principals, and school district administrators. But the tie is real. For example, as the price of his support for the proposed Missouri tax increase, the governor (and many legislative leaders) insisted on a long list of education reforms. There are many examples of reform being resisted by teachers and/or administrators because the proposed reforms weren't to be accompanied by funding increases.

Will there be a new wave of education quality measures comparable to the recent Kentucky and Oklahoma plans? It is difficult to see where they might develop, particularly in 1992. Officials of many states will be trying to avoid or minimize tax increases, sacrificing all new initiatives and maybe a few old ones in the process. In some states, the willingness to raise money for education may go to funding school finance equalization measures, not educational quality measures.

As a result, the emphasis will likely have to be on implementing the many educational quality iniatives that have already been passed. Legislators seeking to advance new quality measures may be forced by fiscal circumstances to focus on those without major cost implications.

ECONOMIC DEVELOPMENT

United Airlines Selects Indiana

> *I am pleased to announce today that the largest economic development project in the United States is coming to Indiana.*

With these words, Governor Bayh touted the new United Airlines maintenance facility offering 6,300 jobs at an average salary of $45,000 each, $800 million in capital outlay, 11,680 jobs from indirect effects, and $100 million a year in new local purchases by the airline.

The facility has been the subject of intense competition, as previously covered in **Reports**. Bayh claimed Indiana won "not because we had the best economic incentive program, but because we had the best combination of factors including incentives, site availability, location, weather and quality of workforce." United Airlines cited about the same factors in its press release and called the competition close and the other proposals outstanding.

Indiana's incentives are $171.5 million which works out to about $25,000 per direct job gained. There are also local incentives valued at $111.5 million. Press reports indicated that Colorado and Oklahoma offers were in the same ballpark. Kentucky dropped out of the competition which its governor suggested had become a bidding war. Comparing bids is difficult because the offers frequently aren't publicized and concessions aren't valued by the same methodology.

The agreement between Indiana and United has provisions often missing in such agreements. Should United not maintain the facility for the stipulated time, Indiana gets its money back.

Is Competition Ruining State Policy?

The scramble for United Airlines illustrates to some the presumed evils of interstate economic competition. Critics are concerned that states will give away the store by tax breaks, infrastructure concessions, and financing. They fear this will increase spending while reducing the tax base, thereby throwing more costs on other businesses and individuals. They worry that competitive pressures to hold down business taxes will promote an unfortunate competition to curtail spending on social programs while redistributing the costs of what is left to individual taxpayers through regressive taxes. They see the competitive process itself as costly for no reason as states are playing a zero-sum game.

Others see competition among states through policy choices as the same healthy process as competition among companies through product options. While more rough and tumble than more structured choices of a planned economy, they believe competition drives state elected officials into efficient policy choices in a way that elections alone could never accomplish. The results are pressures to minimize waste, create high quality educational systems, maintain a good road system, and more.

Prominent experts on federalism and public finance fight out these and other issues in Competition Among States And Local Governments (Urban Institute Press, 1991). The book's editors (Daphne Kenyon of Simmons College and John Kincaid of the Advisory Commission on Intergovernmental Relations) view their effort as a reassessment of thinking on competition issues reflecting "a growing realization of the potential benefits that competition can provide for the citizens of the competing governments." The many authors of the chapters don't all address the same issues and don't always agree when they do. So **Reports'** summary assessments below aren't a substitute for reading the book for those deeply concerned with these issues.

Competition Affecting State Tax Policy

Competition will tend to drop the level of state and local taxes on mobile business activity, like manufacturing or United's maintenance base, to costs of government services provided. This clearly includes transportation and police protection while clearly excluding welfare and leaving education debatable. Other factors, such as the public's preference to tax business rather than individuals, will tend to mitigate this effect.

Competition would tend to hold down the top bracket rates of state income taxes. There is evidence of this occurring in the late 1980s, though mostly in the nature of dropping rates from above 10% to below that figure rather than affecting states with rates in the 5-8% range. An argument can be made that competition would encourage states to rely less on income taxes and more on other taxes and/or make their income taxes less progressive. There is no evidence that this has been occurring.

Competition Affecting Spending Policy

Competitive pressures discourage states from getting too far out of line with other states in their overall level of taxes and thus of spending. But the pressures stimulate spending as well, encouraging states, for example, to avoid an education system that is significantly weaker than those of competitor states. Among spending choices, competition encourages emphasis on activities considered important to business, such as infrastructure and education, rather than social welfare.

Competition Affecting Federal Policy

For those who believe competition is unduly destructive of "ability-to-pay" taxes (like graduated income taxes) and unduly depresses social welfare spending, the appropriate federalism choices are simple. The federal government becomes the prime user of the ability-to-pay taxes, perhaps with some sharing of tax base with the states as now occurs with the estate tax. The federal government pays for social welfare policies (e.g., Food Stamps), provides grants to share in the costs (e.g., Medicaid), or mandates certain minimum standards for states (e.g., Medicaid coverage of pregnant women and welfare for two-parent families). Because these federal policies effectively take the decisions out of interstate competition, those who favor the impacts of competition don't like the policies.

Do Competitive Efforts Make Any Difference?

There is continuing debate over the effectiveness of state economic incentives on business location and expansion decisions. Timothy Bartik enters the debate in Who Benefits From State And Local Economic Development Policies? published this year by his employer, the Upjohn Institute. He concludes that state and local policies do affect growth. Based on complex calculations, he concludes that, "A state and local business tax reduction of 10%, without reducing public services to business, probably increases business activity in a state or metropolitan area in the long run by 2.5%."

Bartik argues that state and local development efforts are not a zero-sum game because they result in steering expanded economic activity to depressed areas where much of the activity will use workers and other factors of production that would otherwise be idle. He gives state and local development efforts two cheers, denying the third because efforts aren't always concentrated in geographic areas with the highest unemployment and because state and local officials sometimes spend too much on concessions to lure particular firms.

TAX POLICY

Debating State Taxes On Business

Introduction: There seems to be little consensus among state officials on business tax policy, at least if a National Conference of State Legislatures October conference is an indicator. The conference, titled "Exploring Business Tax Policy For The 1990s," drew state legislators, academics, state tax experts, and business leaders into two days of discussion of a wide range of tax issues.

Defining Business Taxes: State officials, business leaders, and others involved in tax policymaking aren't all talking about the same thing when they discuss "business taxes," according to William Fox (U. of Tennessee, Knoxville). There are: (1) taxes that business collects but doesn't necessarily pay like income taxes withheld from employees and sales taxes collected from customers, (2) general taxes that business customers pay along with everyone else like gasoline and general sales taxes, and (3) taxes paid only by business like corporate income and franchise taxes. Looking at taxes with an economic impact on business, Fox calculates that the largest burdens are property taxes on what business owns and then sales taxes on what business buys, followed by specific business taxes like income taxes on what business earns.

Taxing Business Versus Taxing Individuals: Public opinion polls continue to show a strong preference for taxing corporations rather than taxing people. This preference wasn't mirrored in the conference where several of the academics and consultants pointed out that corporate taxes actually have their impact (incidence) on individuals. As Fox put it, "Businesses don't pay taxes, people do." Several speakers mentioned a criterion for policy of avoiding taxes that were out of line with competitor states and nations.

Corporate Income Tax Collections: The unsatisfactory performance of corporate income tax collections was reviewed by Robert Aten (Manufacturers' Alliance for Productivity and Innovation) who assessed reasons for slower yield growth than other taxes. The principal reason is a decline in corporate profits relative to other aspects of the nation's economy. Aten gave a variety of reasons why corporate income tax payments would be erratic and suggested the phenomenon would continue. Dan Bucks (Multistate Tax Commission) suggested another difficulty: corporate income that isn't reached by taxes of any state. He called this an "ocean of nowhere income."

Assessing Business Tax Impacts: The multiplicity of taxes having an impact on business was the basis for Michael Vlaisavljevich to urge use of multi-tax models to simulate effects on business in general and on particular industries from tax changes being considered by state officials. He gave an example from work his firm (Price Waterhouse) did for a Florida commission. A study for Florida was also the basis for comments by Steven Waldhorn (SRI International) who stressed the importance of linking assessments of tax policy with state economic development objectives and strategies.

Value Added Taxes: State-level value added taxes continue to be taken seriously in conferences and by state study commissions, though Michigan's decades-old tax is the only example of one now in effect. NCSL's program devoted a whole segment to the subject. Bob Ebel (Peat Marwick) described the tax and its advantages. Robert McIntyre (Citizens for Tax Justice) was critical of the tax as having about the same regressive impacts as a sales tax.

Florida officials are searching for a way to continue to avoid a personal income tax while raising lots more money. The handout from Price Waterhouse showed the implications in Florida of replacing corporate income tax, the intangibles tax, and sales taxes on business purchases with a 2.4% tax on value added. While the gains and losses are identical for business as a whole, they aren't for individual industries. Retail and wholesale sales and services see burdens rise by 95% and 69% respectively while burdens for other industries, such as manufacturing, drop dramatically.

Taxing Particular Industries: Some common situations and themes appeared in the panels that dealt with taxation of telecommunications, common carriers, and financial services. In all three, there has been rapid technological and organizational change that panelists agreed undermined the basis of traditional state taxing methods. In all three, the state response has varied in its speed and its substance. In all three, there is state concern over federal preemption of state taxing authority. In all three, the preemption concern is serious in part because the affected industries can make strong cases that the multiplicity of state procedures create difficult-to-justify administrative costs.

Not Taxing At All: While the conference was about tax policy, not budget policy, several speakers discussed the state fiscal environment -- often citing pressures to raise the overall level of state taxes and spending. Some mentioned "structural deficits," including Tarky Lombardi who chairs New York's Senate Finance Committee. But he complained that the aspect of curtailing spending rather than raising taxes is often neglected. Stephen Lemson (American Express) also urged looking at spending levels, eliminating waste, and setting priorities.

Conclusions: Such a conference inherently doesn't produce conclusions, but there were several points that can be inferred from what was discussed and what wasn't. First, panelists were not interested in shifting more of the state tax burden toward business. Second, they were hostile to tax concessions offered to particular firms to encourage them to locate or expand in a particular state. Third, they seemed more interested in sales taxes on business services and, in some cases, value added taxes than raising the rates of corporate income taxes. Fourth, business and state officials alike were uncomfortable with the situation in taxation of regulated industries like banking, trucking, and telecommunications.

Comparing Tax Burdens In Major Cities

Every year, the District of Columbia budget agency calculates the taxes that would be paid by citizens of the largest city in each state. The comparisons are available for various income levels. The one for a family with income of $75,000 is shown in Table 4. All major taxes are covered, including local property taxes which vary substantially among and within states, local sales taxes, and the local income taxes found in cities like Cleveland and New York. The income level of $75,000 is high enough so that income taxes play a major role in the comparisons, particularly in states with graduated income taxes like Oregon, Wisconsin, and New York. But other states have found ways to tap city families with this income level. Number four, Michigan, has a flat rate tax. In 1990, the year of the comparison, Connecticut hadn't yet adopted its income tax.

The city comparisons aren't valid proxies for state comparisons. For example, Pennsylvania has relatively low taxes by any comparison. But Philadelphia ranks seventh among major cities, in large part because of its wage tax which is over 4%.

Table 4: Estimated Tax Burden for a Family of Four, 1990
Annual Family Income of $75,000

Rank	City, State	Tax Burden	Rank	City, State	Tax Burden
1	Portland, Oregon	$11,484	26	Boston, Massachusetts	$7,435
2	Milwaukee, Wisconsin	11,474	27	Phoenix, Arizona	7,344
3	New York City, New York	10,608	28	New Orleans, Louisiana	6,986
4	Detroit, Michigan	9,570	29	St. Louis, Missouri	6,985
5	Bridgeport, Connecticut	8,982	30	Jackson, Mississippi	6,937
6	Portland, Maine	8,941	31	Oklahoma City, Oklahoma	6,875
7	Philadelphia, Pennsylvania	8,940	32	Albuquerque, New Mexico	6,839
8	Atlanta, Georgia	8,909	33	Billings, Montana	6,661
9	Providence, Rhode Island	8,885	34	Wichita, Kansas	6,641
10	Baltimore, Maryland	8,849	35	Chicago, Illinois	6,604
11	Newark, New Jersey	8,733	36	Charleston, West Virginia	6,499
12	Columbia, South Carolina	8,728	37	Indianapolis, Indiana	6,491
13	Omaha, Nebraska	8,530	38	Little Rock, Arkansas	6,399
14	Cleveland, Ohio	8,282	39	Wilmington, Delaware	6,214
15	Boise City, Idaho	8,267	40	Fargo, North Dakota	6,106
16	Des Moines, Iowa	8,261	41	Birmingham, Alabama	5,545
17	Minneapolis, Minnesota	8,179	42	Sioux Falls, South Dakota	5,487
18	Louisville, Kentucky	7,922	43	Seattle, Washington	5,473
19	Norfolk, Virginia	7,921	44	Manchester, New Hampshire	5,003
20	Denver, Colorado	7,892	45	Memphis, Tennessee	4,567
21	Salt Lake City, Utah	7,816	46	Houston, Texas	4,507
22	Honolulu, Hawaii	7,681	47	Las Vegas, Nevada	4,160
23	Burlington, Vermont	7,587	48	Anchorage, Alaska	4,063
24	Los Angeles, California	7,580	49	Jacksonville, Florida	4,038
25	Charlotte, North Carolina	7,531	50	Casper, Wyoming	3,277

MISCELLANY

Earmarked Revenues: Pennsylvania officials have dealt with one problem of earmarking revenues while setting up another. When the state lottery was created, funds were earmarked for the elderly. The lottery's rapid growth led to programs with few counterparts elsewhere, such as paying for prescription drugs outside of Medicare. Now lottery growth has slowed while the growth of the elderly population and drug prices remains rapid. So this year, some of the increase in the business franchise tax went to the lottery fund. The new earmarking is for transit. Rather than the regional sales tax used by many states, Pennsylvania will use a hodgepodge of state levies. One is a sales tax on magazines. Retailers are complaining that they have no way to separate sales tax receipts on magazines from receipts on other items.

Curtailing Legislative Power: Now that the California Supreme Court has upheld the Proposition 140 voter initiative, the legislature must decide what to do about its restrictions on legislative staffing. The proposition mandates a cut of about 40% in legislative spending. Some reduction has already been taken by the offer of termination benefits made earlier this year. Now at issue are the legislative staff agencies, the auditor and the Legislative Analyst, the legislative fiscal staff. One option is apparently lodging one or both outside the legislative budget. The measure also limits House members to three two-year terms and Senators to two four-year terms.

TECHNICAL NOTES

Budget Data: Under fiscal pressure, states seem to have engaged in an unprecedented degree of creative budgeting this year. This makes the survey data somewhat unreliable, though useful as the only information available. The data are reliable as indicators of what is in the announced state budgets. But the projections are unreliable if used on the assumption that comparable reporting practices are being followed in all states. These concerns aren't unique to **Reports**, they are extensively aired in the NCSL report.

The changes in appropriations shown in the chart on p. 6 illustrate the problem. **Reports** compared the appropriation for FY 1991, as reported by NCSL last fall and the estimated spending for FY 1991 as reported this fall. The elementary and secondary education cuts appear to be dominated by reductions of 24% in Florida and 19% in Indiana. These aren't representative of real cuts in state aid but are likely to reflect: (1) shifting of funding by a matter of weeks to get costs out of one fiscal year and into another and (2) use of funds other than the general fund to defray state obligations to school districts.

There are similar problems with other programs. The shift from FY 1990 spending to FY 1991 AFDC spending estimated this year was -35% in New Jersey and 56% in North Carolina. Budgeted increases for FY 1992 ranged from 39% in Nevada to -15% in Ohio and -16% in North Dakota. In NASBO's latest spending report the changes from FY 1990 to FY 1991 are less varied, but still varied. For example, the AFDC changes are bracketed by increases of 40% in New Hampshire to cuts of 28% in North Carolina.

The full citations of reports relied on in this issue are State Expenditure Report: 1991 (the NASBO spending report), State Budget And Tax Actions: 1990. (NCSL's fiscal survey), Fiscal Survey Of The States: October, 1991 (NASBO's fiscal survey), and Tax Rates And Tax Burdens In The District Of Columbia: A Nationwide Comparison (District of Columbia Department of Finance and Revenue, 300 Indiana Ave., NW, Washington, DC 20001).

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STATE POLICY REPORTS

VOLUME 9 ISSUE 22

IN THIS ISSUE

Many states are now immersed in another round of mid-year budget cutting while anticipating a tight budget next year. Repeating one-time fiscal fixes is inherently difficult. Tax increases aren't attractive. So interest grows in how to downsize state governments.

- Budget Cut Strategies p. 2

The choices for budget cutting are illustrated by a report on ideas for cuts in Massachusetts, a long list of cuts being considered in Maine, and the work of a task force in Iowa.

- Strategies In Three States p. 8

Higher education was the loser in recent state budget battles, but did better in some states than others, with patterns that could be repeated. Large state tax increases didn't guarantee generous higher education budgets.

- Higher Education Finance p. 13

With finances tight, maintaining funding for other programs while avoiding tax increases means finding ways to control Medicaid costs. So far, getting the federal government to pay more is about all that has worked. New hazards for state budgets are developing from the interaction of federal restrictions on bootstrap financing and litigation on rates paid providers of Medicaid services.

- Financing Health Care p. 16

Miscellany covers borrowing without creating debt, economic pump priming by state policies, off-budget taxes and state business climates, and the latest look at how state and local finances are responding to recession. Technical notes detail sources and calculations.

- Miscellany p. 21
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BUDGET CUT STRATEGIES

Introduction

Unless the economy turns around suddenly, and we're not seeing those indications, this is going to be a difficult year.

This recent comment on California's situation by the Legislative Analyst (legislative budget officer) applies to most of the states. Results through October suggest they have experienced all or some of a list of bad fiscal news:

- Results in FY 1991 were worse than anticipated when the FY 1992 budget was enacted, so balances brought into the new year were lower than expected.
- Tax collections during the first third of FY 1992 have been below expectations.
- Because of the collections experience in the early part of the year and lowered expectations of national and state economic forecasters, revenue estimates for the remainder of the year are being reduced.
- Practically nothing is costing less than the amount appropriated for it, but many big-ticket programs, particularly Medicaid, are costing more.

As a result, the search is on again for ways to close state budget gaps.

In many states, this will be a different search than in late 1990 and the first half of 1991. The new search is likely to put more stress on permanent reductions in state spending patterns. Spending cut choices look comparatively more attractive because there is, for now at least, a stronger-than-usual aversion to tax increases.

Avoiding both painful spending cuts and painful tax increases by the one-time methods of balancing budgets -- running down balances, using Rainy Day funds, accelerating revenue, and postponing spending -- is clearly the most attractive alternative to many state officials. These options were used in the pre-election environment of 1990 in many states. They were used extensively again this year to try to retain balance in FY 1991 budgets while revenues fell below estimates and to balance FY 1992 budgets.

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This heavy use in 1990 and 1991 results in two handicaps as state officials now try to deal with FY 1992 shortfalls and FY 1993 budgets. First, the most attractive measures have already been used. Balances can't be drawn down twice. Assets can't be sold twice. By definition, one-time measures can't be used again. Second, the previous extensive use of one-time measures now exacerbates the fiscal problem. New revenues in FY 1993 must first cover spending financed with one-time revenues in FY 1992 and then cover growth in spending.

Avoiding Tax Increases

I find no sentiment anywhere for a tax increase.

This was Governor Schaefer's comment after attending a November meeting with Maryland legislative leaders about a shortfall that may require cutting some $850 million over the next 18 months, a large chunk of the $11-12 billion in spending. Last year Schaefer pushed a tax increase. He might do so again, but not until it appears that spending cuts are unacceptable.

... if there were easier choices, we would have made them.

This was how the governor's press secretary defended the $122 million package of cuts recently proposed to rebalance the FY 1992 Maine budget which is now viewed as 3-4% out of balance. He was suggesting that the legislative majority (D) had little choice but to accept the general thrust of the cuts proposed by Governor McKernan (R). As in many states, leaders are assuming that tax increases aren't a viable option.

> *The truth is, while California's tax burden is still lower than some of our competitors, it has reached the highest level we can tolerate. As we work to close a budget gap in the year ahead, it will be closed through spending cuts, not tax hikes.*

This was what Governor Wilson told a business audience in November after learning that October revenues were nearly $200 million below the forecast. Combined with shortfalls in previous months and known spending overruns, the disappointing revenue figure suggested a high probability that the state's budget is far from balanced. The major tax increases adopted earlier this year are not proving enough to salvage the situation.

Part of California's problem is like that of other states. The recession apparently didn't end on schedule. Another part of the problem is that California's economy doesn't appear to be outgrowing the national economy as it did through the 1980s.

According to the Commission on State Finance, California's budget gap (defined as the shortfalls in the current year plus those in the new budget year) looks close to $6 billion. The action earlier this year was designed to close a gap of $14 billion. The total California budget (all funds) is about $56 billion.

Many Factors Discourage Tax Increases

Raising taxes and cutting spending can be seen as competing ways to balance state budgets. Raising taxes always starts as the underdog. Public opinion clearly favors cutting budgets which the public believes are excessive. Public opinion favors cutting, not raising, taxes. Elected officials of both parties have with few exceptions campaigned on the basis of their ability and determination to control spending and avoid tax increases. So it isn't surprising that this fall, like others before, most elected officials are talking about ways to cut spending and assuring the electorate that tax increases aren't on the table.

In addition to all the normal problems with tax increases, there are some special factors affecting their acceptability in 1992. The first is that many elected officials have already been to the tax increase well. Over the past three years there have been cumulative tax increases of more than 10% in 21 states. The second is that in most states this is an election year, a time when elected officials are least enthusiastic about raising taxes.

Third, it is a year when the media apparently will be filled with discussion of possible national tax cuts, and thus of arguments why taxes should be cut, not why they should be increased. Fourth, early 1992 appears likely to be a period of economic hard times. So tax increases can be characterized as hurting the taxpayers when they can least afford it. A sophisticated version of the same argument is that tax increases pull purchasing power out of the economy when government should be stimulating purchasing power by putting money into it, or at least remaining neutral.

Tax Increases Over Three Years

Mirror, mirror on the wall. What states raised taxes most of all?

As legislators and governors of many states prepare for reelection in 1992 and a few governors seek the Presidency, there is likely to be considerable interest in their records on budgets and taxes. Objective quantitative comparisons aren't easy to make as **Reports** discovered upon being quizzed at length recently by Erik Kriss of the Syracuse Herald-Journal, who is surely but the first in line with such questions.

The concern with recent tax increases isn't necessarily the right concern. The history of recent *increases* says nothing about the *levels* or *burdens* of taxes, which depend upon the starting points as well as the changes. Looking at legislated increases leaves out automatic revenue increases which are much greater in some states than others. Finally, looking at state taxes leaves out state action that encourages local tax increases.

Past tax increases can be a significant factor in state fiscal strategies. Legislators and the public aren't as likely to accept increases in states which have had several large increases in recent years as they are in states which have had no significant recent increases. So tax increases are clearly ruled out in states such as Connecticut and Pennsylvania. They are more a possibility in states with no major increases in three years such as Alabama, Idaho, Indiana, Utah, and Virginia. In some states, there has been considerable discussion of increases, but no increases. Examples are Colorado, Kansas, and Mississippi.

Table 1 was developed from previously reported tax increases -- See Technical Notes for details. It shows the percentage by which state tax revenues have been increased as a result of legislation enacted in 1989, 1990, and 1991.

Table 1: Tax Increases Enacted 1989-1991 As Percent of Tax Revenues

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	34.4%	18	Maine	11.6%	34	Colorado	2.6%
2	Nevada	22.6	19	North Carolina	11.3	35	Maryland	1.7
3	Vermont	22.1	20	Illinois	11.0	36	Alabama	1.5
4	Pennsylvania	21.5	21	Missouri*	10.3	37	Wyoming	1.4
5	New Jersey	21.0	22	Delaware	9.5	38	Idaho	1.3
6	Rhode Island	20.7	23	Tennessee	8.9	39	South Carolina	1.3
7	Alaska	18.8		**United States**	**8.8**	40	Mississippi	0.8
8	West Virginia	18.8	24	Texas	8.2	41	Louisiana	0.7
9	Nebraska	18.2	25	Montana	8.1	42	Kansas	0.4
10	Massachusetts	17.1	26	Arizona	7.9	43	Iowa	0.2
11	Arkansas	14.8	27	Oklahoma	6.2	44	Michigan	0.0
12	Kentucky	14.5	28	Oregon	6.2	45	Utah	-0.2
13	North Dakota*	13.2	29	New Mexico	5.1	46	South Dakota	-0.4
14	California	12.3	30	Minnesota	4.9	47	Virginia	-0.7
15	New Hampshire	12.2	31	New York	3.8	48	Indiana	-1.5
16	Georgia	11.9	32	Washington	3.6	49	Wisconsin	-2.9
17	Florida	11.8	33	Ohio	3.0	50	Hawaii	-11.0

Only one state, Hawaii, made major tax reductions during the three years. Hawaii's economy was extremely prosperous during the late 1980s. The state gets much of its revenue from a steeply graduated income tax not indexed for inflation so revenue growth tends to be substantially greater than economic growth. Five other states show reductions. They generally represent minor adjustments (e.g., dealing with the Davis case on taxing pension income) rather than across-the-board attempts to reduce state tax burdens.

Forty-three states raised taxes during the three years. The largest increases were in the Northeast, particularly New England. These states experienced the economic downturn before it affected the rest of the nation and have continued to suffer more than other states.

Most of the tax increases have had the effect of financing state operations even though some were sold at the time as being primarily for something specific, usually education. A few were large enough or earmarked enough so that all or part of them can be considered as designed to lower property taxes or prevent property tax increases that would otherwise have taken place. Because this use of funds -- raising one tax to lower another -- is more acceptable than higher spending, officials of many states claim this result. The increases most closely tied to lowering property taxes are those in New Jersey, Nebraska, and Oklahoma.

The Emphasis On Budget Cuts

With tax increases ruled out, at least for now, and widening budget gaps appearing, many states are again looking at how to cut budgets. In some, the issue is mid-course corrections required to keep this year's budget in balance, with Florida, Georgia, and Maine good examples. In some, the issue is the FY 1993 budget which appears to have a gap that elected officials would rather close by spending cuts than tax hikes. In some, such as Mississippi and New Jersey, the issues arise because new leaders were recently elected with pledges to cut the budget.

Changing The Nature Of Cuts

Some of the state budget decisions of 1991 reflected a determination to bring long-term spending and revenue into balance. California is a good example. Besides raising taxes, the state ended its automatic escalation of AFDC benefits, altered some features of its pension system, and revised its fiscal and programmatic relationships with counties in health and welfare. Pennsylvania settled on long-term funding for Philadelphia area transit, set up new financing arrangements for Philadelphia, and revised its relationship with local governments in funding child welfare.

Many of the budget decisions of 1990 and 1991 didn't reflect long-term decisions like these. Instead they featured one-time revenues, one-time expenditure reductions, and deferrals of costs into future years. They often included freezes of travel, pay, and/or equipment purchases that aren't tenable in the long run. Even in California, the process of developing long-term budget balance was incomplete. Some of the tax increases are temporary. Proposition 98's built-in increases in education remain, and thus some structural deficit probably remains also.

New Looks At Long-Term Budget Balance

With shortfalls appearing again, officials of some states will be shifting their attention toward more permanent budget cuts. This will particularly be true in those states that have structural deficits, built-in imbalance between outlays to maintain current services and revenues from existing taxes.

Structural imbalance depends upon the observer's view of what spending is needed to maintain current services. In projecting budgets, officials of some states will include outlays such as those required to fund increasing costs of a multi-year education quality plan while officials of other states don't include such outlays. Some include inflation adjustments for employee pay and cash assistance for welfare recipients. Some don't. So no national list of states with structural imbalances can reasonably be constructed.

From a national perspective, revenue systems will have much to do with the long term outlook. A revenue system that won't likely keep pace with personal income is likely to be associated with imbalance. Examples are the sales-tax-dominated revenue systems of Florida, Tennessee, and Texas and the excise-tax-dominated revenue system in New Hampshire. By indexing its income tax for inflation, California also limits its automatic revenue growth. By contrast, tax systems of Ohio, New Jersey, Minnesota, and especially Hawaii capture economic growth and then some. Capturing economic growth is of little value if there isn't much growth to capture, so the outlook in West Virginia and the Northeast is less sanguine than in, say, Idaho or Texas.

Spending factors also affect the outlook. Florida's and California's education cost problems are inherently worse than those of New York because the two sunshine states are experiencing sharp growth in public school enrollment and in the age group that creates the demand for spaces in community colleges and universities. The combination of demographics and the phasing in of federal AFDC and Medicaid mandates gives Southern state budgets an upward thrust not matched elsewhere.

Long-term looks at whether structural imbalance exists and what to do about it are discouraged by state budget procedures that call for balance to be restored in the current fiscal year and don't require balance over an extended period.

In New York, there is serious discussion of combining the shortfall problem for the remainder of FY 1992 (which ends in the spring) with the problem expected in FY 1993. Controversy is bound to develop. The combination can be viewed as the good management practice of taking a longer view of budget balance. But it can also be viewed as just a way to roll the current year deficit into a future fiscal year without solving it.

STRATEGIES IN THREE STATES

Every state has many mechanisms for generating ideas for budget cutting. The players extend beyond executive budget offices and legislative fiscal staffs to task forces and think tanks. Three states -- Maine, Massachusetts, and Iowa -- illustrate what is happening.

Assessing Options In Maine

The Upward Spending Thrust: Maine officials are under considerable pressure to cut spending. With coffers flush from New England prosperity of the late 1980s and expectations high, they adopted many expensive new initiatives including state-funded property tax relief and initial steps toward a state-funded universal health program.

Facing Reality In 1991: By the election of 1990, the affordability of such programs was an issue. Incumbent Governor McKernan contended some spending cutbacks would be appropriate but that tax increases weren't necessary. His opponent claimed the situation was worse than the governor was admitting. By early this year, the governor, who was reelected, had endorsed a tax increase. By the end of the session, it became one of the largest tax increases in the nation and was combined with cuts in state aid that tended to stimulate local tax increases as well. The session was a bitter one that ran well beyond the beginning of the fiscal year and involved various closings of state operations.

More Shortfalls Develop: It now appears that these steps weren't enough. A shortfall of about 3% of the current budget is anticipated to result from revenue shortfalls and some spending overruns. There is general agreement that adjustment should be made by spending cuts rather than another tax increase. Furthermore, there appears to be agreement that the problem is not temporary. As a result, one-time revenue items and temporary furloughs are likely to be less favored while permanent changes such as eliminating programs will be more favored.

Ideas For Budget Cutting: As state officials held public hearings around the state on the options, attention concentrated on a dozen concepts:

(1) reduce the revenue sharing program which provides about 5% of all sales and income tax revenue to local government,

(2) cut school aid across the board and/or reduce the portion of administrators' salaries covered in the foundation formula,

(3) tighten welfare by curtailing the general assistance program and imposing stiffer work requirements in AFDC,

(4) eliminate the demonstration health insurance program,

(5) reduce compensation of state employees who recently got 7% raises under a three-year agreement dating from more prosperous times by (a) salary cuts and (b) requiring a larger employee share of health insurance costs,

(6) cut tax relief provided for excessive property tax burdens under the circuit breaker program,

(7) require co-payment in some social service programs,

(8) curtail some special state activities that are much more extensive and expensive than in other states -- in Maine this means land use and growth management,

(9) privatize state liquor stores and contract out operation of the lottery,

(10) consolidate some higher education campuses and state offices in rural areas,

(11) reconsider some of the sentencing practices that are increasing prison populations, and

(12) downsize the state Department of Education.

The list resembles similar lists being considered in other states. The items on it are not new. Most have been considered and rejected in the past. The question is not whether anyone has new ideas for spending less but whether the Maine climate for consideration of such ideas has changed.

Relaxing Mandates: One aspect of the proposals in Maine is a willingness to relax state mandates to relieve some of the fiscal pressures state aid cuts will put on local government finances. This concept was a prominent feature of aid cut discussions earlier this year in the Massachusetts and New York legislatures and probably elsewhere.

Assessing Options In Massachusetts

> *Pioneer Institute's competition to encourage innovative thinking about state government has produced a bumper crop of well thought-out ideas. Everyone interested in state government will gain from reading Invitation To Change*

These words of praise from Governor Weld provided a stamp of approval for the published results of an innovative effort by Pioneer Institute, a Boston-based think tank. Massachusetts citizens were asked to make suggestions for improving state government, given time and a little money to perfect the suggestions, and given space in Invitation To Change to write up their suggestions. The results are summarized below.

Privatizing: Getting more money out of state authorities (transit, wastewater treatment, airport, turnpike, etc.) was a feature of Bay State budget-balancing proposals in the late 1980's. Change suggests selling Logan Airport to realize about $400 million and improve service. Another suggestion is to lease unused state land in Boston as parking lots.

State Representative John Bradford contributed a detailed suggestion that volunteer services be used to handle home care for the elderly that the state can't afford. Volunteers would accrue credits entitling them to services of other volunteers should they need them later. The suggestion is modeled on an apparently successful program in Missouri. Linking business volunteers and state economic development efforts was also suggested -- a concept sounding much like the Minnesota Business Partnership and parallel ideas in other states.

In purchasing day care services, one suggestion is to move to a voucher plan. Contracting out is suggested for pharmacies in state institutions and collecting child support payments.

New Financing Methods: The suggestion by Morgan Stanley & Co. for Boston-area transit deals with the $450 million annual subsidy resulting from the state paying a larger share than other states pay for transit costs. The subsidy has grown 70% in four years because there appears no other place to look for money. Fares aren't increased more than they have been out of fear of driving riders away. Local share hasn't been increased because of fiscal problems of local government and the state-imposed limits on local property taxes. Federal spending has been limited by federal policy choices. The major policy recommendation is to raise more money by using a dedicated revenue source from the area served such as a regional sales tax or auto registration fees.

Improved Management: One difficulty constantly encountered in using management improvement recommendations to save money is that the recommended improvements often mean spending more, not less, in the budget under review. The payoffs tend to be hard to measure as they take the form of unenforceable promises of lower future costs or unmeasurable promises of improved services. The suggestions from Ernst & Young for Bay State vehicles provide an illustration. The immediate costs are developing a better information system, increasing preventive maintenance, and more purchases of new vehicles to replace old ones that presumably are in stock because equipment purchases have been deferred. Immediate savings would, however, result from following the suggestion that fewer employees be given state vehicles for commuting.

The proposals for tightening enforcement of Medicaid rules against those who conceal assets before or while getting Medicaid payment for nursing home costs also involves immediate costs, though the savings are potentially dramatic.

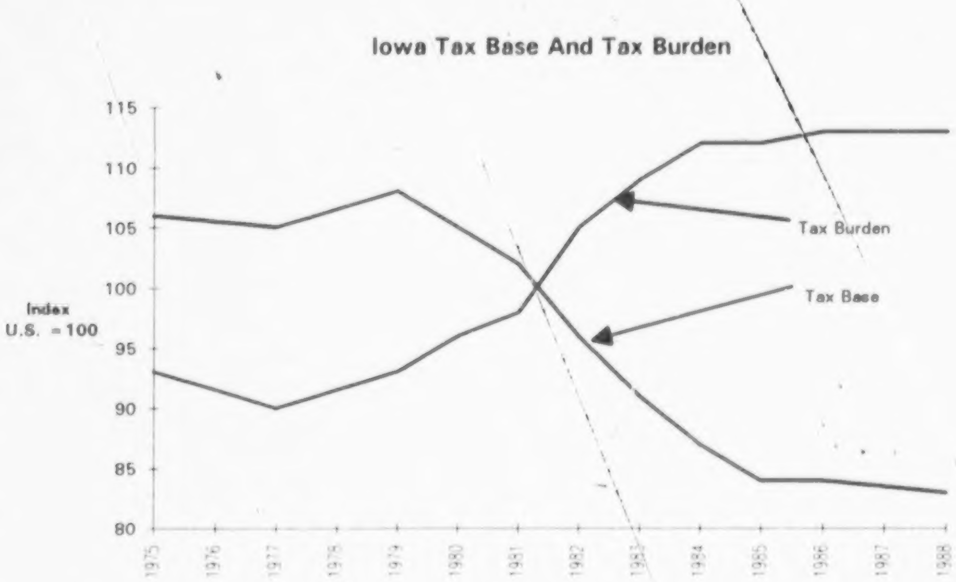
Unintended Or Misunderstood Consequences: The Pioneer report includes two items under "works in progress," both illustrating costs of other policies. The first concerns early retirement options for employees offered to: (a) induce retirement or (b) compensate employees involuntarily terminated for fiscal reasons. In Massachusetts, the lifetime benefit from early retirement costs more than twice a regular retirement. The second concerns the projections for the "uncompensated (health) care pool" that were made when the state passed universal care legislation in 1988. Those costs were expected to decline through initial universal care policies (mostly not implemented) and various cost-saving measures (not implemented). The pool now costs the private sector over $340 million a year.

Downsizing In Iowa

Adversity is a great educator.

This is part of the rhetoric used by business executive David Fisher, who chairs a governor's efficiency task force, as he talks up the need to consider Iowa government practices with, as he puts it, "no sacred cows."

Shrinking The Economy Without Shrinking Government: Much of Iowa's problem stems from a failure to change state and local policy to reflect the state's changing demographic and economic circumstances. The state had an above average economic base and was able to sustain above average spending with below average tax burdens. As the economic base deteriorated relative to the rest of the country, the patterns of government spending were maintained, leading to higher-than-average tax burdens.



The graph tells the simple story. As Iowa's tax base dropped from above average to below average its tax burdens rose from below average to above average.

Coming To Grips With The Problem: The problem was put dramatically by the editors of the state's major newspaper (Des Moines Register, October 27):

> *Personal income in Iowa stopped growing on pace with the national average. Poverty has risen to distressing levels. Over time, those trends will be devastating. An Iowa that is slipping farther and farther behind the rest of the nation will not be able to maintain its outstanding schools, its fine universities, its level of public services.*
>
> *Already it has begun. State government leaders are convinced that Iowa has more government than its people can afford, but there is no agreement on what to eliminate or how.*

The governor, a significant number of legislators, and much of the population don't want to consider increasing state or local tax burdens. To this end, the task force is considering ideas comparable to those being considered in other states.

Privatization: The state has already gotten out of the retail liquor business, the first state to do so since 17 states decided to run liquor stores when Prohibition ended. Consideration is now being given to eliminating prison farms, selling state-owned recreational facilities, such as a golf course, selling the state TV station, and using contractors more and state employees less.

Standard Budget Cuts: The usual range of budget cut options are being considered. Closing one or more large mental hospitals is a possibility. So is eliminating some programs in higher educational institutions, but not closing institutions.

Local Government Reforms: Iowa has seen a massive redistribution of population. Rural areas, excepting a few growth centers, have lost population while metropolitan areas have seen gains. Governmental institutions and state policies haven't shifted as fast as people. For example, the distribution of state highway and road money puts more money into rural areas than traffic would suggest. The school aid program has elements favoring rural districts, although Iowa no longer gives aid for "phantom pupils." These were pupils counted in the per pupil aid formula who would have been attending school if each district had maintained its past enrollment levels.

Ideas now under relatively serious consideration include consolidation of the 425 school districts and perhaps even consolidation of some county governments. Consolidation of the judicial system is also being discussed. Reducing the state's outlays for property tax relief through homestead and farmland credits is also under discussion. Such a move would make property taxes more expensive for taxpayers and presumably increase resistance to unnecessary local government costs.

HIGHER EDUCATION FINANCE

Higher Education Feels The Pinch

Higher education hasn't fared well in the tough fiscal environment of the last several years. Table 2 shows the annual average of the two-year change in state funds for higher education from FY 1990 to FY 1992. It is a measure of support from state dollars, uniformly excluding tuition and federal revenues even though some states include one or both in their budgets.

Table 2: Annual Change In State Higher Education Support, FY 1990-FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	15.5%	18	Michigan	4.5%	34	Ohio	1.0%
2	Idaho	12.0	19	New Hampshire	4.5	35	Alaska	0.5
3	Kentucky	11.5	20	Utah	4.5	36	Illinois	0.5
4	Montana	10.5	21	Wisconsin	4.5	37	New Jersey	0.5
5	Arkansas	10.0	22	Maine	4.0	38	Georgia	-0.5
6	Oklahoma	10.0	23	Pennsylvania	4.0	39	North Carolina	-0.5
7	New Mexico	9.0	24	Texas	4.0	40	Connecticut	-1.0
8	Oregon	9.0	25	Wyoming	4.0	41	Maryland	-1.0
9	Nebraska	8.0	26	Iowa	3.5	42	Missouri	-1.0
10	Hawaii	7.5	27	Delaware	2.5	43	Tennessee	-1.0
11	South Dakota	6.5	28	Minnesota	2.5	44	Vermont	-1.5
12	Washington	6.5	29	Colorado	2.0	45	Florida	-2.5
13	North Dakota	6.0	30	South Carolina	2.0	46	Mississippi	-2.5
14	Indiana	5.5		**United States**	**1.5**	47	Virginia	-2.5
15	Arizona	5.0	31	California	1.5	48	New York	-6.5
16	West Virginia	5.0	32	Kansas	1.5	49	Rhode Island	-8.5
17	Louisiana	4.5	33	Alabama	1.0	50	Massachusetts	-14.0

Probably the most striking aspect of Table 2 is the large number of negative numbers it shows. About a fourth of the states cut their higher education support in nominal dollars, that is even before considering inflation. After discounting increases for inflation, half to two-thirds (depending on the inflation measure used) of the states cut university budgets. These results aren't just one year of grim fiscal circumstances, they are half of two years of change. So they represent a two-year slice suggestive of the budget outlook for much of the 1990s.

Examining which states raised support most and least is suggestive of tight times for higher education in many circumstances. The states in the top ten, with a 7.5% increase or more, involved combinations of these factors: (1) extraordinary enrollment growth as in Nevada and Idaho, (2) relatively prosperous state economies as in Hawaii, Idaho, and Oregon, and/or (3) tax increases sold on the basis of education spending as in Arkansas, Kentucky, and Oklahoma. These combinations are found predominantly in less populous states, which is why the national average is lower than 30 states.

Many of the states which raised taxes substantially (see Table 1) decreased higher education support at the same time. Examples are Connecticut, Illinois, Massachusetts, New Jersey, North Carolina, Rhode Island, and Vermont. Their new money went to balancing the state budget or to balancing plus some objective other than higher education such as local aid in Illinois and public schools plus property tax relief in New Jersey.

Higher Education Losing "Its Share" Of State Budgets

Table 2 suggests that these have been tight times for public higher education, but then these have been tight times for states and thus for other state programs as well. So higher education may just be sharing in the general fiscal misery. If true, this would suggest that state university officials need only adjust to temporary adversity while awaiting the budget bonanza that will inevitably follow from national economic recovery and the ensuing generous state budgets.

Table 3 suggests this assumption isn't true. It contrasts the percentage increase in each state's higher education budget with the corresponding increase in its total general revenue fund (GRF) budget. The difference is the edge that higher education enjoyed over other state programs.

> The numbers in Table 3 don't correspond to those in Table 2. The years are different, FY 1990-1992 in the first and FY 1991-1992 in the second. Also, as detailed in Technical Notes, Table 2 reflects what higher education administrators stress on a nationally uniform basis while Table 3 is from summary totals legislators use when explaining what they did in appropriations bills.

That edge is -2.7%. Higher education appropriations are up 2.2%, considerably less than the 4.9% increase in general fund appropriations. That spread will increase as the year progresses. Universities and community colleges have set their spending patterns for the 1991-1992 academic year and generally won't exceed them. So there won't be substantial supplemental appropriations for them just as there won't be for public schools. But there will be large supplemental appropriations for other programs, particularly Medicaid. So through the year, the general fund increase may rise while the education increase doesn't.

Increases in state taxes didn't necessarily help higher education much. In California, higher education appropriations were reduced as taxes were raised nearly $7 billion. Two of the largest percentage increases in the nation were in Connecticut, where higher education rose 1.2%, and Pennsylvania, where higher education rose 4.5%.

Table 3: Percentage Increases In Higher Education and General Funds, FY 1992

Rank	State	Percent Increase			Rank	State	Percent Increase		
		H. Ed.	GRF	Diff.			H. Ed.	GRF	Diff.
1	Nevada	17.1%	7.1%	10.0%	26	West Virginia	2.1%	4.5%	-2.4%
2	North Dakota	13.4	12.9	0.5	27	Wisconsin	2.0	4.6	-2.6
3	Kentucky	12.7	10.1	2.6	28	Arkansas	1.9	4.9	-3.0
4	Montana	11.3	11.3	0.0	29	Ohio	1.5	4.5	-3.0
5	Oklahoma	10.3	4.4	5.9	30	Iowa	1.4	4.3	-2.9
6	Maine	10.2	1.6	8.6	31	Connecticut	1.2	5.2	-4.0
7	Hawaii	8.4	-1.1	9.5	32	Kansas	0.8	1.1	-0.3
8	Oregon	8.3	8.3	0.0	33	New Jersey	0.2	18.3	-18.1
9	New York	7.5	-1.6	9.1	34	Delaware	0.1	3.7	-3.6
10	South Dakota	7.2	6.8	0.4	35	Wyoming	0.0	0.0	0.0
11	Idaho	6.1	7.3	-1.2	36	Florida	0.0	11.1	-11.1
12	Michigan	5.2	-0.8	6.0	37	South Carolina	-0.3	2.9	-3.2
13	Utah	4.7	4.0	0.7	38	California	-0.4	7.0	-7.4
14	Pennsylvania	4.5	12.3	-7.8	39	Vermont	-0.5	3.7	-4.2
15	Alabama	4.5	-2.6	7.1	40	Illinois	-0.8	7.8	-8.6
16	Washington	4.0	8.5	-4.5	41	North Carolina	-0.9	3.7	-4.6
17	Colorado	3.9	3.3	0.6	42	Maryland	-1.2	4.8	-6.0
18	Georgia	3.8	-1.0	4.8	43	Alaska	-1.3	-0.2	-1.1
19	New Mexico	3.7	6.3	-2.6	44	Minnesota	-1.5	-6.0	4.5
20	Nebraska	3.3	3.6	-0.3	45	Tennessee	-1.9	0.8	-2.7
21	Indiana	3.2	0.2	3.0	46	Mississippi	-2.1	2.8	-4.9
22	Texas	3.1	12.0	-8.9	47	Louisiana	-3.6	0.1	-3.7
23	New Hampshire	2.9	13.0	-10.1	48	Virginia	-3.9	-4.3	0.4
24	Missouri	2.5	1.2	1.3	49	Rhode Island	-8.2	1.6	-9.8
25	Arizona	2.2	4.4	-2.2		Massachusetts	No Data		
	United States	**2.2**	**4.9**	**-2.7**					

When the rest of state budgets rise faster than budgets for higher education, the share of state budgets going to higher education will shrink. This creates some interest in mechanisms that would preserve a past year's share. This is what California's Proposition 98 does for elementary and secondary education, defined to include community colleges. One result is shown on Table 3. In California universities have been squeezed between growing shares for corrections and Medicaid and a constant share for public schools.

There doesn't seem to be much activity to define a constant higher education share. In some states higher education interests have focused on increasing the size of the budget pie, rather than maintaining the relative size of their slice. The Missouri tax increase rejected by voters in November reflected this perspective, with nearly half the new money destined for higher education.

FINANCING HEATH CARE

It's going to be the issue of the 90's in this country, and it will be the issue of 1992 in New Jersey.

With this comment, Governor Florio announced he would concentrate on health care in the next legislative session. As in many states, doing anything with a substantial impact will be difficult.

State Health Care Initiatives

There is no shortage of proposals for state action on health care. Most states, including New Jersey, have had blue ribbon commissions examine the subject and make recommendations. Those recommendations usually call for extracting large sums of new money from three players: (1) private employers through mandates of coverage or payment (pay or play) and, in New Jersey's case, additional taxes, (2) the state through more extensive Medicaid coverage, tax credits for private insurance, and state administration of new plans, and (3) the federal government through its share of Medicaid expansion.

The problem is that most states aren't in a position to put up additional resources. New Jersey is a fine example. The FY 1992 budget was balanced only by one-time items like selling state assets and advancing tax collections from utilities. Although nothing official has been announced, the FY 1993 budget is likely to be way out of balance, something like 5% of spending on a current service basis. No one is talking about raising taxes. Republican legislators, who have veto-proof majorities as a result of the November elections, are talking about repealing one cent of the sales tax. Under those circumstances, funding the Garden State's existing health care programs will be difficult.

This will concentrate attention on off-budget financing, such as the roughly 20% surcharge the state already places on hospital bills to cover costs of uncompensated care. This is an unpopular plan. Its renewal last year overcame opposition from those wanting more, and those wanting less, state involvement. Ultimately, they found they couldn't agree on anything else, so they renewed the plan. A similar battle could occur this year.

Despite fiscal problems, there will be consideration of plans in some states. For example, Governor Carlson is pushing a plan in Minnesota that would use funds from a steep cigarette tax hike to subsidize care for low-income families and the self-employed.

In Massachusetts, the major current issue is the effort to deregulate hospital rates and limit cross-subsidies for uncompensated care. The governor argues that competition will encourage efficiency. Hospitals serving a large proportion of non-paying patients claim it will drive them out of business. The Senate cochairman of the joint committee dealing with the bill used stinging language to explain his unexpected support, "I favor putting the scorpions in the same bottle -- the Beth Israels {hospitals}, the HMOs, and the rest -- and letting them fight it out."

Possible Compromise On Bootstrap Financing

A tentative compromise between the Bush Administration and representatives of the states has apparently been reached on Medicaid bootstrap financing. There are many hurdles to be jumped before any compromise becomes final. So there will be uncertainty as the governors develop their final budget recommendations..They are likely to presume the continued availability of existing arrangements or close substitutes for them.

The close substitutes may generate the most controversy. Many states will be needing money as a substitute for donations and certain provider taxes that will be ruled out by the agreement. They will also be looking for money to fund rapid growth in Medicaid spending. But they will be looking to avoid "new taxes." This could generate interest in special gross receipts taxes on prescription drug sales and gross receipts of nursing homes, hospitals, and perhaps physicians. Interest could be particularly great in states where such levies wouldn't provide money for the general fund and arguably wouldn't be classified as new general taxes.

Whether this politically desirable result occurs largely depends on the providers. In cases where providers oppose such levies, as has been the case in Florida, they are labeled a "sick tax" and the opposition campaign makes it impossible to enact them quietly. But some of the provider taxes supported by providers have been enacted quietly. As indicated by their omission by some states in the NASBO and NCSL fiscal surveys, these haven't all been treated as new taxes.

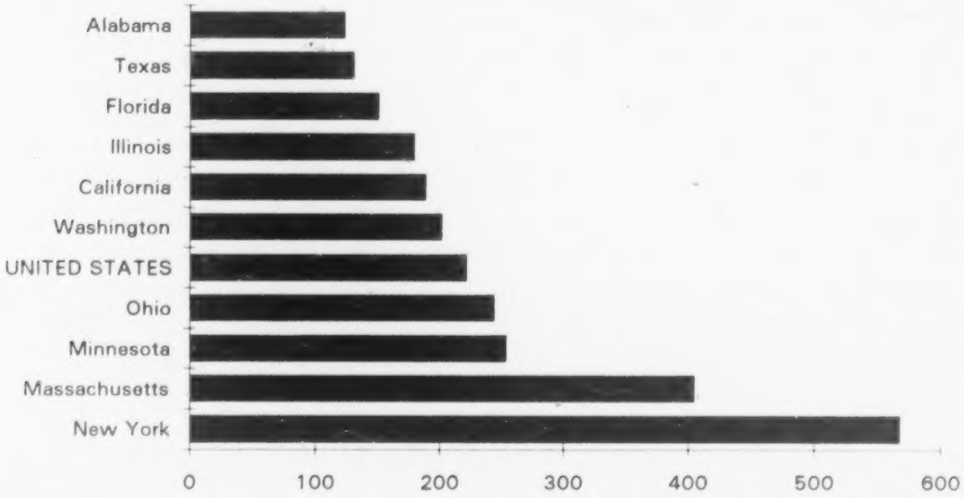
Getting In On The Action

New Hampshire's legislature met in special session in November to solve its budget shortfall problem without cutting services or raising unpopular taxes. Using bootstrap financing was so generally acceptable that the session took only one day. The result is viewed locally as a revenue infusion of about $115 million, solving a budget gap of about $100 million. This is gap-closing of $100 per capita. If all states duplicated the Granite State action with the same per capita results, their gain would be about $25 billion. That is almost twice all the money raised by all the state general fund tax increases this year.

What Makes Medicaid So Expensive?

Faced with consequences of spending rising at 15-25% a year, state officials are constantly asking whether Medicaid costs too much and what might be done to control costs. One way to address this question is to examine the components of costs and the factors, such as health care price increases and changes in numbers of recipients, that drive the changes in overall Medicaid budgets, as is done periodically in **Reports**. Another approach is to compare costs among states and see why some states spend much less than others. The chart suggests that there is considerable difference to be explained.

Per Capita Medicaid Costs, FY 1989



The chart suggests that New York could cut its Medicaid spending in half by just conforming its policies to the national average, that the average state could realize substantial savings by moving to the policies of Illinois or even California, and that practically all states could cut costs by following the policies of Alabama or Texas. As part of a recent assessment of possibilities for cutting the Massachusetts budget, Jane Little (Federal Reserve Bank of Boston) examined these differences for 50 states.

Little's 67-page study provides considerable detail on factors affecting costs in each state compared to the 49 others. Some of the key conclusions are summarized in Table 4. It shows (1) per capita Medicaid costs, (2) an index comparing the relative percentages of poverty-level people who participate in Medicaid to the national average which is set at 100, and (3) an index comparing the cost per Medicaid recipient adjusting for the mix of caseload. Put another way, the second column compares the success (failure, from another perspective) of getting people into the Medicaid program and the third compares the cost per recipient of those in the program.

Table 4: Medicaid Cost And Cost-Influencing Factors, FY 1989

State	Per Capita Cost	Indices Of: Participation	Indices Of: Cost
New York	$568	103	160
Massachusetts	405	134	119
Minnesota	254	88	192
Ohio	244	138	140
United States	**222**	**100**	**100**
Washington	202	134	121
California	189	115	66
Illinois	180	87	89
Florida	151	88	78
Texas	131	75	93
Alabama	124	67	61

The table's second column suggests that New York's extraordinarily high per capita costs are not caused by eligibility criteria that are out of line with other states. Such criteria do appear to be a significant factor contributing to higher costs in Massachusetts, Ohio, and Washington and to lower costs in Alabama and Texas.

As shown in column three, New York and Minnesota have substantially higher costs per recipient than the other states. This can reflect several factors: (1) higher hospital and physician fees, (2) more extensive treatment, and (3) coverage of elective Medicaid services not provided in other states.

Little's assessment of prospects for reducing costs is not encouraging for those seeking Medicaid savings in state budgets. Not only do federal mandates increase current costs, the mandates being phased in cut off avenues of potential cost saving. Protecting against state cost-saving measures is, of course, exactly what proponents of the mandates were trying to accomplish. Little typically follows her discussion of each cost-saving measure with a discussion suggesting that the costs will reappear somewhere else in state budgets. However, there are some suggestions for cutting cost, particularly in administering asset tests for persons going into nursing homes.

Litigation On Provider Reimbursement Rates Pushing Costs Up

As executive budget offices put the finishing touches on the governors' FY 1993 budgets, reimbursement rate litigation remains a potentially significant cost factor. These cases were initially pursued by hospitals. After their U.S. Supreme Court victory, which established their right to have reimbursement rates decided in the courts, nursing homes quickly joined the action.

The cases don't necessarily result in immediate budget increases, but can result in settlements or ultimately in final judicial determinations that do increase spending. For example, Illinois "lost" its case in October when a federal judge ruled that state officials hadn't used the appropriate procedures and criteria for determining the nursing home reimbursement rate. But the judge didn't order a rate, so now state officials will make a rate determination. It will become subject to litigation if not accepted by the nursing homes.

The next step was recently taken in Pennsylvania. More than a dozen plaintiffs -- representing child advocacy groups, doctors, and others -- are suing the state. Part of the relief being sought is expanding the reimbursement logic of hospitals and nursing homes to physicians. This is the other shoe dropping from the Supreme Court case. The ultimate outcome could be expensive, but the case could stay in litigation for several years. Besides reimbursement rates, the suit goes to the substance of Pennsylvania's program, arguing that the state should do whatever is needed to reach more clients. For example, the American Academy of Pediatrics, one of the plaintiffs, says that the Keystone State is reaching only 18% of the population eligible for its preventive care programs.

Provider Rates And Bootstrap Financing

The provider rate cases arise from a provision of federal Medicaid law which indicates rates should be "reasonable and adequate." Cases under that provision, sometimes called the Boren Amendment after the Senator who sponsored it, could interact with bootstrap financing to leave states holding the bag for rate increases adopted earlier this year. Some states made higher reimbursements contingent on bootstrap financing, but could find they must keep the higher rates without the financing. The Illinois Economic and Fiscal Commission describes the situation in its Autumn Update on state finances.

> *While it is not clear what action the federal government will take, the Illinois assessment program will proceed until a ruling is made. During the first week of October, the Illinois Department of Public Aid billed providers $71 million. Later in FY 1992, provided the federal government's ruling is delayed or dropped, two more billings totalling an estimated additional $370 million during FY 1992 will be made. This would trigger approximately $440 million in federal reimbursements to Illinois under this program in the current fiscal year. If the Medicaid Provider Assessment Program is prohibited in FY 1992, state law requires that unexpended assessments already collected be returned to the providers and that reimbursement rates revert to those in effect last year. This could be problematic, however, given the "Boren Amendment," which requires states to reimburse Medicaid providers at rates that are "reasonable and adequate."*

In simple terms, some states agreed to pay higher rates because bootstrap financing made it possible to pay them without taxing their budgets. Their laws say if bootstrap financing disappears so do the higher rates. But it won't necessarily happen that way. Even without bootstrap financing, states will face the usual arguments for provider rate increases. They might also face litigation under the Boren Amendment. In that litigation they would face the task of explaining how a rate previously determined to be reasonable and adequate became excessive when federal bootstrap financing rules changed

MISCELLANY

Borrowing Without Debt

In October, the Illinois legislature was debating alternative approaches to the timing of school aid payments. The issues were complex, with a unique vocabulary (e.g., the "thirteenth month school aid payment"), but the substance is simple. The state delays a school aid payment enough to "save" one twelfth of its school aid spending but not so much that schools lose one-twelfth their revenue. In some cases, the state pays interest, which the Illinois governor has been offering.

These kinds of arrangements aren't new. New York has been using its "magic window" for decades. The news is that their use appears to be spreading. The concept of delaying payments and reimbursing the recipient for borrowing cost (lost interest) is applicable to vendors like hospitals providing Medicaid services as well as local governments. The economics is essentially the same as the state borrowing money to make payments. The public perception presumably differs, which is why the device is being used.

Pump Priming

The traditional Keynesian prescription for stimulating the economy is for government to put more money into the economy by spending and take less out in taxes. With balanced budget requirements, there isn't much states can do to fill this prescription. They can't cut taxes without cutting spending and can't increase spending without raising taxes. So the stimulative effects of one policy is offset by the depressing effects of the other.

States can spend borrowed money for capital outlays. The possibilities include accelerating spending for already approved projects and authorizing new projects and borrowing. There are many models of this approach, such as the Build Illinois and Build Indiana programs, though much of the their impact has been in recovery rather than recession periods.

Some governors have talked of similar actions in this recession. Maryland is the latest with what the governor calls "Maryland Goes To Work." Governor Cuomo has applied the concept regionally with a state effort to revive the economy of Long Island. These initiatives aren't having dramatic impacts because of difficulties associated with accelerating projects such as environmental impact statements, getting legislative approval, and the hang-up of federal highway legislation in the Congress.

Speech Material

For an overall summary of fiscal circumstances suitable as an introduction for whatever a speaker wants to cover, try NCSL fiscal expert Corina Eckl's closing from "Strapped States Face Hard Choices" in State Legislatures (November):

> *As legislators and staff recover from what many describe as their most trying sessions ever, more bad news is on the horizon. With the ink barely dry on recently enacted budgets, many states have already cut budgeted levels for FY 1992 as revenues have come in below expectations. If the national economic recovery is slow, as several economists predict, state lawmakers will once again confront the painful dilemma of reconciling limited revenues with uncontrollable spending demands. 1991 legislative sessions were merely a prelude to 1992 sessions -- not a pleasant thought for most policymakers.*

Taxes, Other State Policies, And Business Climate

Current issues in Massachusetts provide a reminder that the taxes used to finance state budgets aren't the only game in town for business taxpayers. The three big issues now being considered involve financing that takes place outside the general fund of Massachusetts and other states. One is Workers Compensation, financed by a payroll tax in some states and assessed as insurance costs in others, where a rate increase of 20-50% is in the cards. Another is Unemployment Compensation, where the state is already borrowing from the federal government. A large tax increase -- in the rate, the taxable payroll base, or both -- is in the cards. The third is the fund that pays for uncompensated hospital care which economically works as a tax on health insurance. Boston-area businesses also face escalation in water and sewer charges which are already about $500 a year for a typical household of four and are slated to rise to about $1,000 in 1995 as the construction to clean up Boston Harbor progresses.

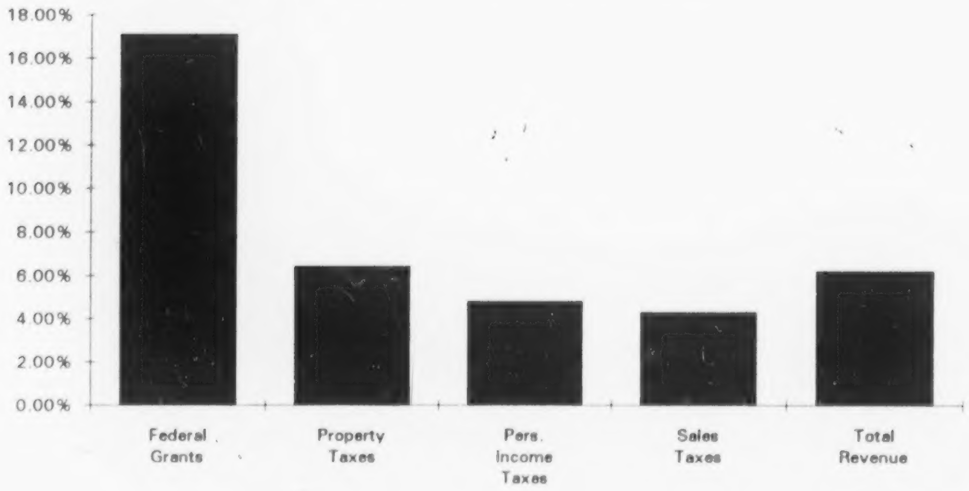
The California Chamber of Commerce recently announced results of a poll of more than 1,000 employers on priority state issues. Taxes were the highest priority, as might be expected after this year's tax increase and announcements that there is another major budget shortfall. Workers Compensation was a close second. Other major issues were education, environmental permit procedures and costs, liability law, recycling, and state water policy. The chairman of the Chamber's task force on saving jobs has recently relocated several ZERO Corp. operations to Utah. He notes employees experience lower costs for housing, auto registration, and auto insurance. His Workers' Compensation premiums are 60% lower while health insurance costs are 35-50% lower.

State And Local Finances Bottoming Out?

The state and local fiscal picture isn't good, but isn't any worse than it was a year ago, according to new estimates released by the Commerce Department. In the third quarter of this year, state and local governments ran a deficit of $31.3 billion. That's about the same as the third quarter a year ago and an improvement over the $41 billion deficit of the first quarter and the $33.1 billion deficit of the second quarter. State and local governments run some deficits even in good times, but the current deficit is higher than normal, such as the $20 billion deficit during 1989. One piece of good news is that the rate of increase for spending (6.3%) is about the same as the one for receipts (6.2%). Another is that employee retirement funds are growing at nearly $5,000 for every employee-year being worked.

There are messages in the revenue growth comparison on the chart below.

Growth In State/Local Revenue, 1990III To 1991III



One message is that federal grants are growing much more rapidly (17.1%) than total state and local revenue (6.2%) or any of the major taxes shown. It is simply incorrect to talk about overall cuts in federal aid to state and local government. The second message may prove to be important as early as the elections of 1992. Property taxes have been rising faster than other major taxes. Public opinion polls indicate voters like property taxes less than sales or income taxes. Legislators and governors generally place considerably more stress on relieving property tax burdens than sales or income tax burdens.

The 6.2% growth in property taxes is significantly larger than some politically salient growth rates during the same period like personal income (3.1%), consumer prices (about 3.5%), market values of homes (probably a small negative number), and market values of commercial and industrial property (probably a large negative number).

TECHNICAL NOTES

Tax Increases: The tax increases shown on Table 1 are the sum of increases reported in annual summaries by NASBO or NCSL as selected at the time as the most useful survey. The increases were reported in **Reports** (Vol. 7, Issue 16, 1989), and State Budget & Tax News (Vol. 9, Issue 18 for 1990 and Vol. 10, Issue 21 for 1991). Tax increases have been defined slightly differently by different reporting organizations and from year to year by the same organization. The percentage for each year is roughly the annual amount of increased revenue from tax changes divided by the prior year's tax revenue. The U.S. figure of 8.8% is the sum of state dollar increases divided by the prior year revenue. The average of state percentage changes is 8.4%. The table includes the 1991 Missouri tax increase of 8.1% put to voters by the legislature and rejected and the 13.2% 1989 North Dakota increase referred to voters by voter petition and rejected by voters.

Higher Education: The data in Table 2 are what is known in higher education as the "Chambers numbers," a long-time data series maintained by Edward Hines of Illinois State University. They appear in his publication Grapevine and the Chronicle Of Higher Education (11/6). They measure resources states add to higher education including scholarships but excluding tuition. Table 3 is based on reports to NCSL by legislative fiscal offices appearing in State Budget And Tax Actions, 1991. Inclusions and exclusions conform to the differing practices of individual states.

Medicaid: Little's analysis, Why State Medicaid Costs Vary: A First Look was published as a working paper by the Federal Reserve Bank of Boston. The data in Table 4 deal with non-elderly persons eligible for Medicaid because they receive cash welfare assistance. There are separate tables in the report dealing with other groups.

Finances: The finance numbers on p. 23 are presented at seasonally adjusted annual rates. They come from the National Income and Product account estimates of the Commerce Department's Bureau of Economic Analysis. To develop the totals shown in the text, **Reports** had to provide its own estimate for corporate profits taxes, which are less than 3% of total receipts. Accounting conventions for gross national produce explain why there is a perpetual state and local deficit. When capital outlays are financed by bonds the bond proceeds aren't counted as revenue but the capital outlays are counted as spending. The personal income tax entry in the chart is the BEA category personal tax and nontax receipts. BEA shows growth of only 2.1% for narrowly defined personal income taxes.

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VOLUME 9 ISSUE 23

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- Higher Education Choices p. 2

This seems to be the year for sharp cutbacks in welfare, but the action is concentrated primarily in a few states and on one little known program, general assistance. State officials continue to seek a contract with welfare recipients committing recipients to seek work and/or meet standards for raising their children. Caseloads and costs have been rising. New statistics on poverty suggest further increases are possible.

- Dealing With The Poor p. 9

Reports from three states illustrate a common problem: more spending and less revenue than anticipated. The shortfall this year often presages one for next year. Most state officials haven't decided what to do, but have decided they don't want to raise taxes.

- Fiscal Problems Continue p. 15

There are dramatic differences among state/local tax systems in how they treat rich and poor. One measure shows over half the states have regressive taxes.

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Young people think more highly of state governments than the aged.

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Two new data books provide material for a quiz. Technical notes detail sources and calculations.

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December 1991 (First Of Two December Issues)

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HIGHER EDUCATION CHOICES

Higher Education Under Fiscal Pressure

Higher education hasn't fared well in the tough fiscal environment of the last several years. By one measure, state appropriations grew at an annual rate of 1.5% in the two years ending in FY 1992. By another measure, the increase in FY 1992 was 2.2%. By any measure, among the large programs of state government -- welfare, higher education, public schools, corrections, and Medicaid -- higher education has been faring least well. Its budget increases have even trailed those of the residual "all other" category.

The situation in many states is worse for higher education than these statistics suggest. The national averages were lifted substantially by a dozen states with either unusually prosperous economies (e.g., Hawaii, Idaho, and Oregon) or major tax increases (e.g., Kentucky, Pennsylvania, and Oklahoma). There were actual cuts in appropriations in 13 states by the two-year measure and in 14 states by the one-year measure. The tables in Issue 22 provide state-by-state detail on higher education's budget problems.

Adjustments To Adverse Fiscal Conditions

Budgets to maintain current services in higher education would cover inflation plus any changes in workload, which for the bulk of higher education activities means full-time equivalent (FTE) enrollment. There is more to public higher education than teaching, but the expensive other activities -- university hospitals, extension services, and sponsored research -- tend to be funded separately. Confronted with state subsidies insufficient to cover enrollment changes and inflation, the public institutions have four broad options for maintaining their operations:

(1) finding other sources of income, with tuition increases having the largest potential followed by increasing alumni and other contributions and selling services such as research, special institutes, and conferences,

(2) reducing their workload by serving fewer students,

(3) increasing their efficiency, broadly defined as the ratio of outputs (e.g., student hours taught) to inputs (e.g. faculty members), and

(4) reducing the cost of their inputs, specifically salaries which are by far the most costly input.

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Raising Tuition To Compensate For Appropriations Cuts

A typical reaction of university administrators confronted with state unwillingness to pay for their product at prices they consider appropriate is to find someone who will pay, rather than change the product. In practice, this means looking at the potentials of tuition increases to maintain spending levels and programs. The math of the trade-off between tuition increases and state appropriations means that relatively small "shortfalls" in state appropriations translate into relatively large tuition increases, particularly in states with traditions of low tuition and high public support. This is illustrated in Table 1.

Table 1: Tuition Increase Needed To Produce Five Percent Per Student Spending Increase

	State Appropriation Increase Percentage					
State Share Of Costs	7.5%	5.0%	2.5%	0%	-2.5%	-5.0%
25%	4%	5%	6%	7%	8%	8%
50%	2	5	8	10	12	15
67%	0	5	10	15	20	25
75%	-2	5	12	20	28	35
85%	-9	5	19	33	48	62

Each entry in Table 1 is the percentage increase in tuition required to give a university or college a 5% increase in spending when tuition is added to the state appropriation increase. How much the tuition increase must be for this to happen depends on: (1) how much the state aid increases, as shown in the column headings and (2) what percentage of instructional costs is paid by the state, as shown in the row headings.

Many states aspire to stable policy in higher education finance, with the ratio between student-financed and state-financed cost constant, such as one-third or one-fourth for the students. To maintain this policy the percentage increases in total spending, tuition, and state support must all be the same. In the table, the target rate of spending increase is 5%, so the 5% column shows the results of a 5% increase in state support. Tuition also needs to rise 5%, regardless of the percentage cost sharing between students and the state.

In states like Vermont and New Hampshire, tuition carries a high percentage of costs, typified by the entries on the top row of the table. In that situation, universities can offset state appropriation decisions by relatively small changes in tuition. But most states are typified by the 67% and 75% state shares shown, with community college tuition sometimes providing 15% or less of costs as shown in the bottom row. In those cases, relatively small changes in state budget decisions cannot be offset by politically feasible tuition increases. For example, to allow a university to increase spending by 5% while the state appropriation is frozen requires a 28% tuition increase in a state that provides for three-fourths of university cost.

Sharp Tuition Increases

On a weighted average basis, tuition at public four-year institutions this year is 12% higher than a year earlier. On an unweighted basis, the increase was 14%. The difference suggests that the greatest increases were found at the smaller institutions. Those increases are massively above the comparable number for private four-year institutions (7%) and even more above inflation (3-5% depending on measure and time period used). Referring back to Table 1, a 12% increase happens to be about what it would take to live with about a 2% increase in state support and still produce about a 5% increase in instructional spending. Table 2 provides a sampling of the tuition increases that were adopted this year.

Table 2: In-State Tuition And Fees, 1991-1992, Selected Institutions

State	School	Total	Increase
Arizona	Arizona State	$1,590	3%
California	Cal. State (Sacramento)	1,048	17
California	U. of Cal. (Berkeley	2,369	17
California	Los Angeles Mission Comm. C.	120	20
Colorado	U. of Colorado (Boulder)	2,308	2
Florida	Florida State U.	1,413	8
Illinois	Malcolm X Comm. C.	985	20
Illinois	U. of Illinois	3,054	7
Michigan	U. of Michigan (Ann Arbor)	3,846	10
Massachusetts	U. of Mass. (Amherst)	5,052	45
Massachusetts	Mass. Bay Comm. C.	1,818	33
New Jersey	Rutgers U. (Camden)	3,670	12
New York	City U. of New York (Brooklyn)	1,955	44
New York	State U. of NY (Albany)	2,285	54
North Carolina	U. of North Carolina (Chapel Hill)	1,213	15
Pennsylvania	Penn State (Univ. Park)	4,402	9
Texas	U. of Texas (Austin)	1,100	8
Virginia	U of Virginia	3,354	13

There are no tuition freezes in the table. Several states, particularly New York, have frozen tuition with pride when circumstances permitted. Most states have some increase every year. Some states achieved the single-digit tuition increases shown in Table 2 through major tax increases. In California, the 17-20% increases reflect the role that restraining state higher education increases played in closing the state's $14 billion budget gap. In New York, with smaller tax increases, and Massachusetts, with none, tuition at major state institutions went up roughly 50%.

Tuition's Impact On Enrollment

While tuition can be an alternative to state appropriations as a source of funding for universities, it is also a price being charged in a marketplace. Raising prices tends to reduce the amount purchased as well as increasing the per-unit revenues to the seller. Higher education is no exception. Consumers have many alternatives to paying tuition at a particular state university including: (1) attending private universities and public institutions in other states, (2) attending less expensive institutions such as community colleges, (3) attending less by taking fewer courses, avoiding summer school, or taking a semester off, and (4) discontinuing attendance at any higher education institution and in the case of potential new students, not starting.

Responses to tuition increases are hard to distinguish from responses to other factors affecting attendance. The responses to the changes at the University of Massachusetts (UMass) have been dramatic, though economic decline in the Northeast has also had an impact. Resident student costs, including tuition, have nearly doubled in four years. Meanwhile applications for admission dropped from about 24,000 in 1988 to about 15,000 this year. The school has sought to maintain enrollment levels by dropping admission standards and increasing recruiting efforts. But it has still seen enrollment drop from a mid-1980s peak of about 19,000 to about 17,000 in 1991.

The Market For Higher Education

Higher education faces a difficult marketing situation. Its primary market, recent high school graduates, is showing declines. One recent study predicts a decline of 3.5% in high school graduates from 1986 to 1995. Within this total, there will be significant differences among ethnic groups with a sharp 52% rise from a small base for Latino students, but a 3% decline for African-American students and a 10.1% decline for "white non-Latino" students. Among this group, there are sizeable increases in fast-growing states like Arizona and Nevada and small increases in many Western states. But changes in this group show the marketing problem of public universities in older parts of the country: Connecticut (-28%), Illinois (-14%), Louisiana (-13%), Massachusetts (-31%), Michigan (-22%), New Jersey (-26%), New York (-23%), North Carolina (-10%), Oklahoma (-11%), Pennsylvania (-18%), and Virginia (-10%).

Confronted with a potentially declining group of customers, public higher education has available all the strategies of any seller. First, existing customers can be encouraged to buy more -- dropping out less, taking five rather than four years to finish, and going to graduate or professional school. Second, market penetration, the percentage of high school graduates who attend college, can be boosted. Third, services can be sold outside the primary market by increased participation by older students, foreign students, continuing education programs, and the like. Fourth, students can be attracted away from private sector institutions.

Enrollment Projections Show Slow Growth, Much Variation

Because of these factors, enrollment trends won't necessarily follow the trend of high school graduations alone. Research Associates of Washington, an outstanding source of 50-state comparisons of higher education data, has developed enrollment projections which appear as Table 3.

Table 3: Percent Change in Public Higher Education Enrollment, FY 1991-1996

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Utah	24.5%	18	Montana	5.5%	34	Alabama	0.0%
2	South Dakota	14.6	19	Texas	4.7	35	Illinois	-0.1
3	New Mexico	14.3	20	Georgia	4.5	36	New Jersey	-0.3
4	Nevada	14.1	21	Missouri	4.2	37	Maine	-0.5
5	Hawaii	13.8	22	Louisiana	3.7	38	North Carolina	-0.5
6	Arizona	13.1	23	Oklahoma	3.6	39	Vermont	-0.7
7	Alaska	12.4		**United States**	**3.3**	40	New York	-0.8
8	Idaho	11.3	24	Mississippi	3.3	41	Tennessee	-0.8
9	California	9.3	25	New Hampshire	3.2	42	Rhode Island	-1.1
10	North Dakota	8.6	26	Iowa	3.0	43	Kentucky	-1.3
11	Washington	8.6	27	Nebraska	2.8	44	Indiana	-2.6
12	Oregon	8.2	28	Maryland	2.6	45	Connecticut	-3.0
13	Colorado	7.6	29	Arkansas	2.5	46	Michigan	-3.3
14	Wyoming	7.6	30	Wisconsin	2.5	47	Ohio	-3.4
15	Minnesota	6.9	31	Virginia	2.1	48	Pennsylvania	-4.0
16	Florida	6.7	32	Delaware	1.9	49	Massachusetts	-4.5
17	Kansas	6.2	33	South Carolina	0.8	50	West Virginia	-6.1

On a national average basis, these numbers are low enough so they don't imply any inherent fiscal problems in financing higher education. The projected 3.3% growth over five years is lower than the expected growth rate of the population and of the number of persons employed. So, for example, the number of workers per university student will increase.

There are three stories reflected in the three columns. States in the last column are expected to see no growth. To fund current services in higher education, they only need to provide for inflation adjustments minus the effect of declining workloads. Their higher education officials will not, of course, see it this way. States in the second column closely resemble the mild growth of the national average. The Western states in the first column face the most serious problems. Utah officials are expecting rapid growth, following nation-leading growth in elementary and secondary schools. California's growth is also expected. There is a plan for massive construction of additional campuses to accommodate the growth, though the plan is currently on hold.

Future enrollments are not independent of price and availability. The projections implicitly assume relatively constant policies regarding the percentage of cost paid by tuition, the growth in cost, and the availability of spaces in public institutions. Sharp tuition increases or more restrictive admissions would cut the enrollment projections. These decisions could also redirect some enrollment -- for example, from four-year residential institutions to community colleges.

Closing Out Students

Nobody's fingerprints are on this decision.

With state appropriations growing less than inflation and formidable barriers to raising tuition enough to make up the difference, something has to give. If asked, legislators would probably speculate that their decisions were being handled by two mechanisms. The first is a reduction in the growth of costs of inputs to the education production process, particularly faculty salaries. The second is an increase in what might be called productivity from each faculty member teaching more students, from elimination of marginal programs, and from trimming of overhead. Critics might characterize the same results as a decline in quality. Adjustments of both types are taking place in many state higher educational systems.

There is another possible adjustment -- simply reducing the number of students served. This makes any given state subsidy a greater amount per student. It thus permits salary increases and avoiding hard decisions such as increasing faculty workload and eliminating programs -- decisions that reduce quality from one perspective and represent increased productivity from another. Because turning eligible students away isn't what most legislators had in mind (and is explicitly prohibited in some states), the action is quiet. But not that quiet, as indicated by a lead article in the Chronicle Of Higher Education (11/13) which discussed it. Administrators of many states aren't talking on the record, so the Chronicle relies on those who can be quoted like Patrick Callan, a former California higher education official quoted at the beginning of this section.

However, the polices are explicit in several states. Minnesota, Oregon, and Wisconsin have adopted formal policies of reducing the size of their major four-year institutions. The subject is being debated in higher education circles in Tennessee, Texas, Utah, and probably other states. In Miami-Dade Community College, the changes are so major they can't escape notice. Given declining per-student support from the State of

Florida, college officials are deliberately reducing enrollment by 3,000 students. The college president explains that the choice was to erode the quality of education or limit access to it.

Access And Student Aid

The recent emphasis on tuition increases to finance public higher education has been deeply disturbing to some policymakers. They see education as the ladder upward for individuals as well as for segments of society, such as the poor. To them public higher education should be about as accessible economically as the public schools.

For decades their positions were reflected in no-tuition policies -- actually low-tuition policies when fees were counted -- in the California system and the City Colleges of New York and low tuition at public institutions in Texas and elsewhere. Sharp percentage increases in these and other schools cause these observers to argue that "access" to higher education is being denied on the basis of income.

Another group is critical of low tuition policies for several separate reasons. First, in traditional economic terms they argue low tuition distorts decisions by encouraging people to take courses who wouldn't do so if they had to pay full social cost. As a result of more student hours, there is also more state spending than economically appropriate. Second, they argue that the policies are driving private institutions out of business or at least making their circumstances difficult. Third, they see the low-tuition policy as a state subsidy for the more affluent, whose children are much more likely to attend higher education institutions.

These critics argue for raising tuition substantially, say doubling it, and providing more extensive student aid for less affluent students. This would mean making the policies of all states less like California and Texas and more like New Hampshire and Vermont.

The rhetoric of tuition increase decisions over the past several years has included a commitment to increased scholarship assistance to offset the tuition increases. But this often means no more than reflecting increased scholarship costs because of the tuition increase, not expanding the pool of those receiving aid. Means-tested federal and state scholarships and loans generally do offset rising tuition for low-income persons. High income persons absorb the higher costs. This leaves the crunch for the middle class, creating concerns that they are being squeezed out of higher education.

Given the experiences of the past two years, many in higher education are convinced that some sort of permanent change in state policies toward higher education has occurred. This is possible, but not obvious. Generally the arguments for higher tuition have *not* been a major factor in state decisions. Instead, the operative decision has been appropriation levels, based on the spending pressures of other programs and the revenue situation. State elected officials haven't been endorsing tuition increases, which they have often sought to constrain, with Virginia a good example. Confronted with better fiscal circumstances, those decisionmakers might well seek to return to the division of cost responsibility between student and state appropriations of the late 1980s.

DEALING WITH THE POOR

The New Attack On Welfare Dependency

This is the first time anyone has had the courage to look at the welfare system and make changes.

This was Governor Schaefer's explanation of his recent proposal for reforming the welfare system in Maryland.

As in other states, the pressures for reform in Maryland are substantial. With a population of a little under five million, the state has almost 78,000 AFDC cases and another 24,000 on the state-funded general assistance rolls. The AFDC caseload has grown 20% in the past year. Welfare costs alone are putting pressure on a state budget that is already out of balance. Higher welfare participation also raises costs in other programs, particularly Medicaid.

The concern over welfare caseloads isn't just fiscal. Welfare is seen as a part of a culture of poverty and dependency that is closely linked to a wide range of social problems including crime, drug abuse, and failure of children in the schools. Politically, high welfare spending is a liability because of welfare's unpopularity. High welfare spending can also make it more difficult to mobilize public, and thus legislative, support for other policies. In Governor Schaefer's case, the policies of interest include raising state taxes and providing substantial support from the rest of the state, particularly affluent suburbs of Washington and Baltimore, to meet the needs of Baltimore.

Maryland's legislature is not the only one that will be considering attempts to deal with welfare dependency. The subject has been a hot topic in Michigan and Wisconsin in the past. The governors of California and Massachusetts, and probably many other states, will likely have proposals as part of their FY 1993 budgets. Legislators in many states will undoubtedly also offer plans even where there is little executive branch interest.

These proposals are getting national attention. Some of it views developments with alarm, as suggested by the title of the Newsweek (12/2) coverage, "A Rough Winter, Running Out Of Money, States Are Testing How Hard They Can Pinch The Poor." Some media coverage lauds what are seen as constructive new ideas, such as Ohio's attempts to get young welfare mothers back into school, as featured in Business Week (October 21).

Responsibility As A Theme

The underlying concept of many of the newer reforms is responsibility. That is, society discharges a responsibility to the welfare recipient only if the welfare recipient acts responsibly relative to society. The concept of a contract between the recipient and the state is sometimes used.

The definition of responsible conduct varies from state to state. The Maryland proposal is to cut the AFDC grant by 30%. The recipients earn the full grant back by meeting state standards for: (1) keeping their children in school, (2) making sure their children get preventive health care, and (3) paying their rent. The incentive to keep children is school is part of what Wisconsin calls "learnfare." An incentive to work, or at least seek work and prepare for it, is now a part of all state AFDC programs.

The plans involving placing special requirements on AFDC recipients generally require waivers from the federal government. Changes in general assistance, which is 100% state and local money, do not.

From Welfare To Jobs, Maybe

There is broad consensus that work is the solution to welfare dependency.

Non-incumbent candidates for state and federal office are constantly offering this solution. When they become incumbents, they are constantly implementing it. The result is a constant series of announcements leading to headlines like, "State Planning A Workfare Program" which appeared in the Boston Globe recently (11/6).

These programs are not new. Federal legislation has required states to operate some sort of welfare-to-work program since 1968. The latest version is required by the Family Support Act of 1988, then known as federal welfare reform legislation. It creates the JOBS program, which replaces other programs like WIN, WIN-Demonstration, Job Search, Community Work Experience, and Work Supplementation. In Massachusetts, specific programs, each with a catchy acronym or program title, were adopted in the early Dukakis days of the 1970s, under Governor King, and under the second Dukakis Administration where the program, called ET, received widespread national publicity. The new program will probably have a catchy title also, Mass Jobs. For all of the new emphases, the federal spending for work-to-welfare programs, adjusted for inflation, is less than in the peak year of FY 1974.

While hopes are high for these programs, dramatic results aren't being assumed in federal projections of AFDC costs. As a recent General Accounting Office assessment put it, "However, service and funding shortages and poor economic conditions could decrease states' abilities to operate JOBS and slow their progress." The barriers to success as the programs are currently constituted are formidable:

- It is not economically advantageous for current welfare recipients to work at jobs likely to be available. Forgetting subsidized transition periods, the worker incurs transportation, child care, clothing costs, and taxes. To get what is left after these costs, the former welfare recipient forgoes cash assistance, Food Stamps, Medicaid, and other income-tested programs. In the proposed Massachusetts program, this is reflected in a cutoff point of about $7 an hour, with a welfare recipient allowed to turn down work not paying that much -- a level about twice the minimum wage. An analysis of the California GAIN program by the legislative fiscal staff suggests the breakeven point for a welfare family of three is a job paying $1,400 per month or about $8 an hour.
- Particularly in current economic circumstances, it isn't easy to find a job. Doing so is harder for those without substantial work histories and education.
- Evaluations of past work-to-welfare programs suggest they are only close to breakeven in long term assessment of state government costs and savings. This doesn't mean they aren't worthwhile, but they don't offer the dramatic payoffs that would encourage their funding. This is probably why many states didn't use all the federal money available to them in FY 1991.
- Even if they offer to break even in the long run, the programs involve heavy front-end outlays for training and placement in return for a stream of future savings from avoiding welfare payments -- a cost profile similar to buying new cars to avoid maintenance costs of old cars. In times of fiscal stringency, programs with this cost profile are some of the earliest to be cut in state austerity moves.

Cutting Payment Levels

> *We pay 3 1/2 times the welfare grant that Texas does, about double what Arizona does. I think, in part, we have been an attractive destination for people who were out of work and on welfare in other states.*

Paying less per recipient has always been a potential money-saving adjustment in AFDC and general assistance programs. Conversely, concern over low payment levels relative to living costs and payments of other states has always produced pressures to raise payments.

Over the past two decades, states have been increasing their cash payment levels less than inflation, making the cash payment levels lower in constant dollars. The impact has been offset in part by growing Food Stamp benefits and other programs, such as low-income heating assistance.

Providing no increase in the AFDC grant is a standard response to state fiscal problems, particularly when state employees are doing without pay increases. California cut its cash assistance level as part of budget decisions earlier this year. The payment level may again be under attack, as indicated by the comment of Governor Wilson, quoted above, in discussing ways to deal with the new shortfall that has appeared in the budget.

The extreme disparities in payment levels are shown for selected states in Table 4. Alaska's level is twice the U.S. median payment of $367 a month for a three-person household. Benefits in some states are less than half this amount.

Table 4: AFDC Monthly Cash Payment For Family Of Three, January 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$891	8	Massachusetts	$539	32	Ohio	$334
2	California	694	9	Minnesota	532	36	Florida	294
3	Connecticut	680	11	Michigan	525	41	North Carolina	272
4	Vermont	679	12	Wisconsin	517	48	Texas	184
5	Hawaii	632	18	Pennsylvania	421	49	Alabama	124
6	New York	577	25	Illinois	367	50	Mississippi	120

Reforming General Assistance

The AFDC program handles cash assistance for families with children in the household. The federal SSI program deals with cases involving: (1) age over 65, (2) disability, and (3) blindness. Many persons without income don't fit into any of these categories. These individuals receive general assistance, which involves no federal participation in cost or regulation. Some of these programs are state administered; some are administered by local governments. Benefit levels and eligibility standards vary substantially. In most descriptions, a few states are said not to have any such program.

General assistance is now under attack. The move is most extensive in Michigan, where large numbers of recipients were recently cut off entirely from state assistance. The action has generated national publicity that is likely to lead to similar moves in other states in the budget cutting environment predicted for early next year. There are somewhat similar restrictions on the program now going into effect in other states, such as Ohio.

Measuring Poverty In Individual States

The Census Bureau has recently released estimates of poverty levels by state, subject to caveats appearing in the Technical Notes at the end of this issue. The data appear in Table 5.

Table 5: Percent of Persons In Poverty, Average 1988-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	4.3%	18	Virginia	10.9%	34	New York	13.4%
2	New Hampshire	6.9	19	Alaska	11.0	35	Florida	13.5
3	New Jersey	7.9	20	Hawaii	11.1	36	South Dakota	13.6
4	Rhode Island	8.0	21	Nebraska	11.1	37	Arizona	14.0
5	Delaware	8.5	22	Ohio	11.5	38	Georgia	14.9
6	Wisconsin	8.5	23	Minnesota	11.6	39	Montana	15.5
7	Utah	8.7	24	Maine	12.2	40	Oklahoma	15.9
8	Vermont	9.0	25	Indiana	12.3	41	South Carolina	16.2
9	Washington	9.1	26	North Dakota	12.5	42	Kentucky	17.0
10	Massachusetts	9.3	27	North Carolina	12.6	43	Texas	17.0
11	Maryland	9.6	28	Colorado	12.8	44	West Virginia	17.2
12	Kansas	9.7	29	Missouri	12.9	45	Tennessee	17.8
13	Nevada	9.7	30	Illinois	13.0	46	Alabama	19.1
14	Iowa	10.0		**United States**	**13.1**	47	Arkansas	19.8
15	Oregon	10.3	31	California	13.3	48	New Mexico	21.1
16	Wyoming	10.5	32	Idaho	13.3	49	Louisiana	23.2
17	Pennsylvania	10.6	33	Michigan	13.2	50	Mississippi	25.0

Poverty And Welfare Participation

For complex reasons not fully understood, the participation rate in means-tested programs is substantially below eligibility. The list of reasons includes a mix of pride, lack of understanding, fear of having to deal with caseworkers, and potential statistical errors in estimating the population that might be eligible. There are also some conceptual differences between poverty, measured by income, and welfare eligibility, measured by assets and income. Welfare eligibility also varies considerably among the states. While unable to explain the numbers, **Reports** presents a comparison of selected states in Table 6 (next page). It compares the poverty rate, the participation rate for the nationally uniform Food Stamp program, and the participation rate in AFDC. The rankings assume more participation is deserving of a higher rank.

The expected relationship is that shown for the U.S. There is a substantial fall off from poverty status to participation in Food Stamps and a further substantial fall off from

Food Stamp participation to AFDC participation. Some indication of the generosity of the California payment levels and eligibility standard is suggested by nearly identical participation rates in AFDC and Food Stamps. There are many persons eligible for Food Stamps who can't be on AFDC because there are no children in the household. So, in California, the data suggest there are likely many persons who either cannot or choose not to apply for Food Stamps but do receive AFDC.

Table 6: Percentage Of Population In Poverty and Receiving Food Stamps And AFDC And Rankings Among States In Percentages, Selected States, Various Years

	Ranks			Percentage Participating In:		
State	Poverty	Stamps	AFDC	Poverty	Stamps	AFDC
United States				**13.1%**	**8.1%**	**4.6%**
Mississippi	1	2	2	25.0%	19.4%	6.9%
Louisiana	2	3	3	23.2	17.2	6.7
New Mexico	3	8	19	21.1	10.4	4.1
Arkansas	4	9	40	19.8	10.0	3.0
West Virginia	7	1	5	17.2	20.2	6.1
New York	17	14	8	13.4	8.6	5.5
Michigan	18	11	1	13.2	9.9	7.0
California	20	26	4	13.3	6.5	6.4

Michigan has a larger spread between Food Stamp and AFDC participation. But it leads the nation in AFDC participation despite trailing 10 states in Food Stamps and 17 states in poverty rates. The numbers also suggest there are more recipients of Food Stamps in West Virginia than there are poor people.

Causes Of Growing Caseloads

The large gap between the poverty rate and participation in Food Stamps and AFDC indicates the potential for substantial further growth in those programs. Factors that influence participation may be as important in causing growth as underlying economic factors like poverty and unemployment. Indeed, a recent survey by the American Public Welfare Association asked state officials to rank reasons for caseload growth. Out of 44 states responding, "the worsening economy" was ranked as most important by 25. But officials of 18 listed "enhanced Medicaid benefits program" as most important and another nine listed the Medicaid factor as second most important in causing caseload growth.

The report explains, "As states increase outreach efforts to reach these new populations {women and children newly covered by federal mandate} and determine eligibility for Medicaid services, states are also finding that many are eligible for Food Stamps and AFDC." In simple terms, caseworkers are seeking out expectant mothers and mothers with young children to bring them the preventive health services now covered under Medicaid. In the process, they are finding people who qualify for cash assistance.

Welfare, Medicaid, and Social Priorities

> *The irony here is powerful: because Congress mandated better health care for the poor, at least some Illinois residents will lose welfare benefits.*

With this comment, Newsweek (12/2) bought the argument that federal Medicaid mandates are hurting the poor. The argument is pretty clearly true, though hard to prove except by anecdotal evidence. Medicaid mandates have made state budgets tighter than they would otherwise be. The result has been some combination of taxes higher than they would otherwise have been and allocations for other state programs -- including education as well as welfare -- lower than they would otherwise be.

In state budgets, spending on health care for the poor exceeds by far spending on cash assistance for the poor. In the budgets approved for FY 1992, total Medicaid appropriations were $35.9 billion while AFDC appropriations were $8.1 billion, making Medicaid over four times as expensive. The increase from FY 1991 to FY 1992 was $96 million for AFDC and $6,423 million for Medicaid. Put another way, 98% of the new spending in these programs for the poor is going to health care.

FISCAL PROBLEMS CONTINUE

Introduction

With recession showing no signs of abating, the fiscal circumstances of just about every state are looking worse. Compared with the outlook when budgets were adopted earlier this year, there appears to be: (1) less likelihood that the FY 1992 budget is balanced and (2) more likelihood that the FY 1993 budget to be adopted next year will need major spending cuts and/or tax increases to be balanced. The state-by-state details appear in State Budget & Tax News.

Circumstances are so common among the states that materials from one can almost be lifted verbatim for use in another. To illustrate this, the next three sections quote extensively from recent reports in three different states. The quotations are changed by minor editing. Local references (e.g., Jefferson City) have been replaced with generic citations (e.g., state capitol) and local numbers replaced with citations to "amount." On the theory that which state is which doesn't matter, the states aren't named here. On the theory that readers may not buy that theory, they are listed in Technical Notes at the end of the issue.

Sample Report One: Watchdog Group

The first example of appraisals of state fiscal condition is a summary assessment by an outside watchdog group like an expenditure council, taxpayers' federation, or state chamber of commerce.

> *Earlier this year, the* (governor) *administration was able to close an over $* (amount) *income-outgo gap through a combination of actions, including selected workforce reductions, the deferral of certain payments, and other one-time financing mechanisms as well as* (if applicable) *increasing the tax rates on* (specify). *Even with the new revenues generated, the Governor and lawmakers could only adopt an austerity budget providing* (specify) *percent growth in FY 1992 state spending. Furthermore, as we noted when that fiscal plan was enacted in June, the FY 1992 state budget left "no room for the unexpected," with all of the state's anticipated resources being committed.*
>
> *Unfortunately, the national recession, the* (specify local emergency like floods, bank failure, collapse of local finances) *and the state's high unemployment levels have not only continued to depress state tax collections but also appear to have contributed to mounting welfare and medical assistance caseloads. For example, when the* (state's revenue estimators) *met to review actual collections and the latest economic forecast, they lowered their consensus general revenue estimate for FY 1992 by another $* (amount). *In combination with their earlier revision this summer, the estimators are now expecting only $* (amount) *in receipts in the current fiscal year -- a projected shortfall of $* (amount) *compared to the $ (amount) estimate upon which the FY 1992 budget was based.*
>
> *On the expenditure side of the fiscal equation, caseloads for AFDC, general assistance, and Medicaid are now projected to increase, adding to state expenditures at the same time revenues are falling. The budget imbalance may grow larger if there is a need for increased medical assistance, welfare payments, and other possible deficiency spending items.*
>
> *Of course, the state reportedly received a 'windfall" earlier this year in a federal Medicaid reimbursement for its disproportionate share of low-income patients in public hospitals* (rephrase to reflect exact bootstrap financing plan, if any). *These monies were used to* (reimburse for mechanisms used to balance FY 1991 budget, if applicable) *as well as to establish a reserve to cushion the state against any FY 1992 imbalance.*
>
> *This does not belie the fact that (state) not only faces a significant income-outgo gap in the current fiscal year, but also a potential deficit of over $* (amount) *in FY 1993. Previous fiscal imbalances were closed by increasing taxes, austerity budgets, and one-time financial plans. As the Governor and legislature consider options for dealing with the current difficulties, they should avoid the temptation to turn to "quick fixes" and instead take decisive steps to lose this structural gap by reassessing the role of state government in the 1990s. Now is the time for reform.*

Sample Report Two: Group Interested In Spending

The second example is from a group interested in social service spending.

> *The state's budget, balanced with no room for error, is quickly moving out of balance as a result of revenues already coming in below estimates, general assistance, adult corrections and Medicaid spending exceeding appropriations and several unfunded liabilities. The way things are going, the deficit could build to $* (amount) *this fiscal year.*
>
> *A deficit of this size cannot be made up by budget cuts alone in a budget which is as tight as the one enacted for this* (year, biennium). *There is only $* (amount) *left in the state's "Rainy Day" Fund. Temporary tax increases would be a political "cop-out" which fails to recognize that the state's fiscal problems are systemic -- they are not temporary. They result from the fact that service needs are greater than existing revenue sources will provide. They result from the accumulation of four years when the state drew down its reserves and used other one-time revenue sources.*

Sample Report Three: Major Newspaper

The last example of how fiscal assessments from one state are applicable to many other states comes from a newspaper account.

> *(State Capitol), (Date)-- Governor* (name)*'s budget office said today that the gap in the coming state budget may rise to $* (amount)*, double its previous estimate, or more than* (number) *percent of the total projected budget.*
>
> *Officials said they based the new figure on projections that the state and national economies would take still another turn for the worse, depressing tax collections and increasing spending on social services.*
>
> *The governor seized on the worsening state budget problems as all the greater reason for legislative leaders to agree on a multiyear budget that he said could begin to attack the deficit problems now rather than when FY 1993 is to begin. In the current fiscal year, the state is already facing a gap of at least $* (amount)*, and the governor has warned this could go even higher.*

What Is To Be Done?

> *To put it in simplest terms, the four leaders reported to me that they could not find in their individual caucuses any enthusiasm for a tax increase. So to cut through it, what we are confronted with is the necessity to look at very painful spending cuts.*

This was Governor Wilson's conclusion after meeting with California legislative leaders of both parties in November. The result is indicative of sentiment around the nation that the current shortfalls should be handled by spending cuts rather than tax increases.

A determination in the fall to avoid tax increases the following year doesn't mean there won't be tax increases. Similar determination in 1982, when recession was hurting state finances, was followed by many increases in 1983. State Budget & Tax News (Issue 21) lists 11 states with 30% of the population as places to look for increases in 1992. Even in those states, there is little discussion of tax hikes except in states where increases were discussed this year but not enacted -- Alabama, Colorado, Florida, Kansas, and Tennessee.

COMPARING PROGRESSIVITY OF TAX SYSTEMS

The progressivity of state/local tax systems can be compared by many measures. However, a relatively simple measure like that shown in Table 7 illustrates the differences.

Table 7: Index of Progressivity for the Largest City in Each State, 1990
Taxes at Income of $25,000/Taxes at Income of $100,000

Rank	City	Index	Rank	City	Index
1	Minneapolis, Minnesota	0.43	26	Milwaukee, Wisconsin	0.91
2	**Los Angeles, California**	**0.62**	**27**	**Portland, Oregon**	**0.91**
3	Boise City, Idaho	0.69	28	Atlanta, Georgia	0.91
4	**New Orleans, Louisiana**	**0.69**	**29**	**Louisville, Kentucky**	**0.91**
5	Portland, Maine	0.70	30	Jacksonville, Florida	0.93
6	**New York City, New York**	**0.73**	**31**	**Des Moines, Iowa**	**0.93**
7	Wilmington, Delaware	0.73	32	Newark, New Jersey	0.94
8	**Billings, Montana**	**0.76**	**33**	**Fargo, North Dakota**	**0.96**
9	Charleston, West Virginia	0.78	34	Denver, Colorado	0.96
10	**Little Rock, Arkansas**	**0.79**	**35**	**Phoenix, Arizona**	**0.96**
11	Columbia, South Carolina	0.80	36	Baltimore, Maryland	0.96
12	**Honolulu, Hawaii**	**0.81**	**37**	**Chicago, Illinois**	**1.00**
13	Oklahoma City, Oklahoma	0.81	38	Bridgeport, Connecticut	1.02
14	**Jackson, Mississippi**	**0.81**	**39**	**Omaha, Nebraska**	**1.03**
15	Boston, Massachusetts	0.81	40	Indianapolis, Indiana	1.05
16	**Norfolk, Virginia**	**0.83**	**41**	**Manchester, New Hampshire**	**1.07**
17	Alburquerque, New Mexico	0.83	42	Birmingham, Alabama	1.10
18	**Wichita, Kansas**	**0.83**	**43**	**Philadelphia, Pennsylvania**	**1.10**
19	Burlington, Vermont	0.84	44	Casper, Wyoming	1.11
20	**Charlotte, North Carolina**	**0.85**	**45**	**Seattle, Washington**	**1.12**
21	Cleveland, Ohio	0.87	46	Anchorage, Alaska	1.14
22	**Detroit, Michigan**	**0.89**	**47**	**Houston, Texas**	**1.15**
23	Providence, Rhode Island	0.89	48	Las Vegas, Nevada	1.15
24	**Salt Lake City, Utah**	**0.89**	**49**	Sioux Falls, South Dakota	1.21
25	St. Louis, Missouri	0.90	50	Memphis, Tennessee	1.22

The table expresses the relationship between tax rates as a percentage of income in each city for families with incomes of $25,000 and $100,000. If taxes were proportional to income, both income levels would pay the same percentage, say 9%, though the higher income household would pay more tax. In the table, the proportional tax situation would show a progressivity index of 1.0.

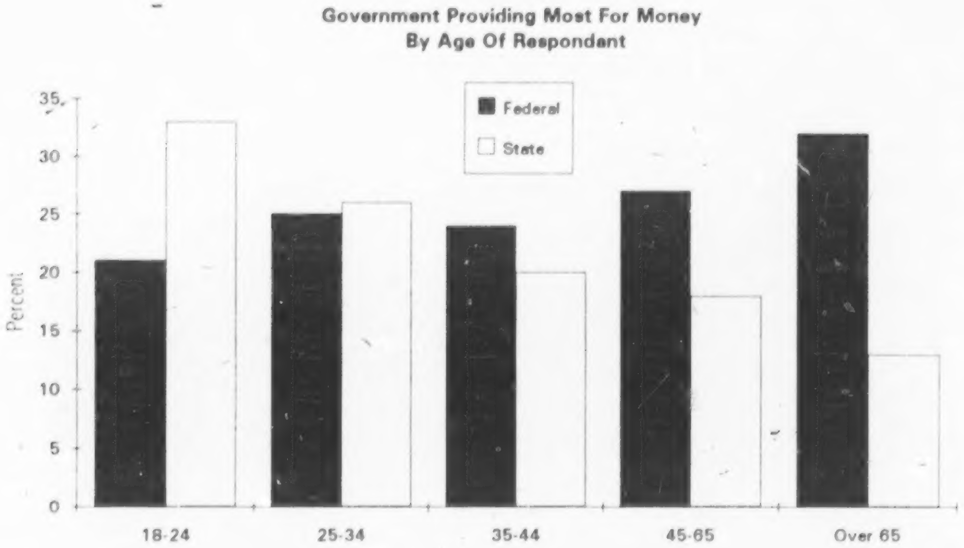
Thirteen states have regressive tax systems by this measure as shown by values over 1.0, meaning that lower income families pay a higher proportion of their incomes in taxes. This is a smaller number of regressive tax systems that many studies of state tax systems show because use of an extraordinarily high income of $100,000 brings out the steepest rate in graduated state income taxes. The states shown as regressive are mostly states without income taxes.

WHICH GOVERNMENT HELPS THE MOST?

The Advisory Commission on Intergovernmental Relation's annual public opinion poll (Changing Public Attitudes On Government And Taxes: 1991) is the standard source of information on which tax is least favored (property), which government spends money most wisely (local), and other public finance topics. The detailed report breaks down the responses by categories of the people surveyed including sex, race, age, education, employment status and occupation, household size, and region. Most of these breakdowns aren't particularly interesting because they show only minor differences or obvious ones, such as the finding that the more education people have the more likely they are to know that states have their own constitutions.

The exception is how differently people of different ages answered the question, "From which level of government do you feel you get the most for your money: Federal, State, or Local?" Overall, local government won with 31%, the federal government placed second with 26%, and state government with 22% tied with "Don't Know/No Answer." Age affected the responses as shown in the chart on the following page. Appreciation of state governments is greatest among younger age groups and drops significantly with increasing age. The fall-off of support extends to local government as well. Support for local government is highest in the 35-44 group and falls off to 28% among those over 65. The federal situation is reversed, with support highest among older persons.

The differences make considerable sense. The federal government isn't a particularly good deal for younger adults who pay the steep Social Security payroll tax as well as the income tax and don't see many benefits. State governments provide universities and community colleges and roads for the younger set as well as paying half of pubic school costs for their children. By age 65, these state contributions are less important, Social Security and Medicare are extremely important, and the federal tax burden drops on retirement.



There is bad news here for support of state and local taxes. The older people get, the less likely they are to think they get their money's worth from those taxes. People are, on average, getting older. Furthermore, the tendency to go to the polls also increases with age.

THE STATE POLICY BOOKSHELF

Two new books have appeared with piles of data on government policy and finances -- enough to provide a basis for a brief quiz.

New States In Profile

The second 1991 edition of States In Profile should reach the 80% of readers who have full service **Reports** subscriptions about the time this issue does. *(To purchase additional copies, call the subscription office listed on p. 2 of this issue.)* Besides providing a deskbook for interstate comparisons, the book, if memorized, can make readers expert enough to get perfect scores on the test below (answers on page 24).

(1) Name three of the six states that experienced the most population growth between 1980 and 1990.

(2) The median age in Florida is nearly 37, well above the national average. Name any one of the next highest six states.

(3) Manufacturing accounts for more than 24% of jobs in five states. Name three.

(4) In the typical state, do state governments raise more money than local governments?

(5) State government debt per capita is now: (a) over $10,000, (b) about $5,000, (c) about $1,000, or (d) well under $1,000.

(6) State and local taxes take about 11.6% of people's income, but the take is over 15% in Alaska (where oil companies pay most of it) and nearly 16% in what state?

(7) Five states qualify as being among the 10 lowest tax states whether low state and local taxes are measured per capita or in relation to personal income. Name two of them.

(8) Federal grants to state and local government average just over $500 per capita. Only two states get over twice the national average. They are states with what characteristic: (1) the least revenue-raising capacity, (2) the largest percentage of poor people, (3) the largest percentage of people living in large cities, or (4) the most revenue raising capacity?

(9) Spending per pupil in public school is at least 30% above the national average in five states and at least 30% below in six. Name three states in either group.

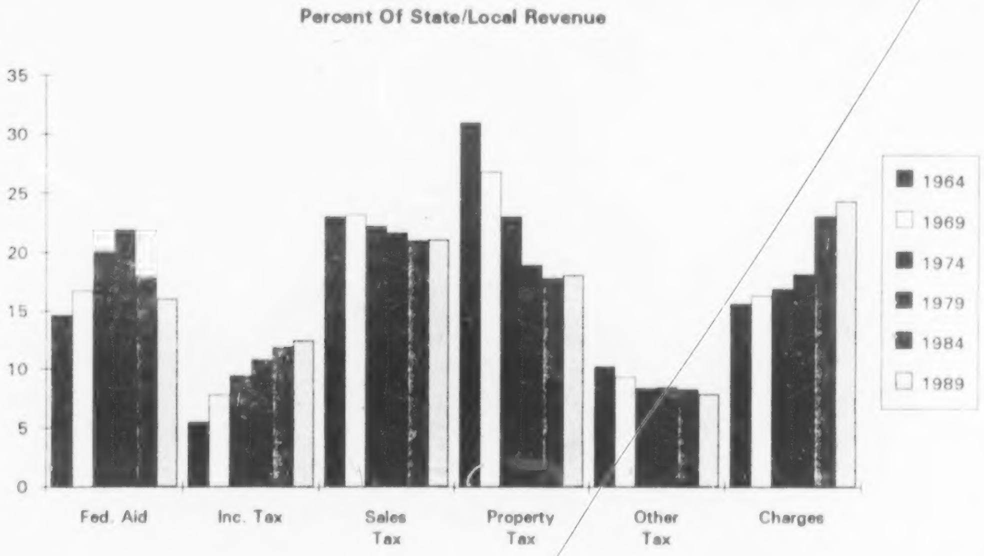
(10) States differ by region in strategies for their "flagship" universities. One region has high spending financed by high tuition, while others have more moderate spending and tuition, and still others maintain relatively high spending with low tuition. Name one region linked with a strategy.

(11) Nationwide, one child in a hundred dies soon after birth but the rate is 20% higher in five states. Name two.

Bonus Question For World Class Trivia Buffs: One state spends only 2.8% of state and local budgets for law enforcement, lowest in the nation and less than half the national average. Its violent crime rate is only one-tenth the national average. Name the state.

New Significant Features

The annual two volume set Significant Features Of Fiscal Federalism belongs on the bookshelves of most readers of **Reports**. The second 1991 volume, with most of the statistical data, 330 pages of it, appeared recently. Its greatest strength is the large collections of historical data, providing national summaries of trends in taxes and spending for all three levels of government. An example is the shift in where state and local governments get their money as shown by the chart.



The chart shows differing patterns for the major revenue sources over the past 25 years. User charges and individual income taxes have played growing roles in financing state and local government while federal aid peaked and receded. Property taxes consistently declined but have shown some signs of revival.

TECHNICAL NOTES

Higher Education: Table 1 was calculated by **Reports** and can easily be calculated by readers for any percentage gain in per-student spending deemed of interest. Table 2 is from the College Board as reprinted in the Chronicle Of Higher Education (10/23). Research Associates of Washington (2605 Klingle Road, NW, Washington, DC 20008) publishes state-by-state statistics on higher education in State Profiles: Financing Public Higher Education 1978 to 1991. It has other publications also oriented to state-by-state comparisons in higher education such as Higher Education Revenues & Expenditures: A Study of Institutional Costs.

Academics being prolific writers, there is no shortage of book-length treatments of higher education finance and management issues generally, and student access issues in particular. For a recent treatment of the affordability arguments that is rich in historical statistics see Michael McPherson (Williams College) and Morton Schapiro (U. of Southern California), Keeping College Affordable (Brookings, 1991).

Dealing With The Poor: The poverty percentages are from the Census Bureau's Poverty In The United States: 1990, a volume that provides considerable demographic detail on the poor. These data are not available by state except for the total poverty population. Census warns against state-by-state rankings but itself calculates year-to-year changes, which is statistically even more adventuresome. These concerns are less serious than undercount concerns. If Census missed 5 million Americas in the 1990 Census, then none of the poverty rates are accurate.

The comparison of AFDC and Food Stamp participation involves slightly differing years. The poverty information is that in Table 5 ranked from high poverty to low. The other participation rates are from the new States In Profile, Table H-4 and H-10. The assessment of JOBS activities from the General Accounting Office (Washington, DC 20548) is Welfare To Work: States Begin JOBS, But Fiscal And Other Problems May Impede Their Progress. The survey of reasons for caseload growth comes from the American Public Welfare Association (810 First St., NE, Washington, DC 20002). The comparison of budgets for AFDC and Medicaid comes from NCSL's State Budget And Tax Actions: 1991.

State Finances: The first sample is from the Rhode Island Public Expenditure Council's RIPEC Budget Watch (11/7). The second is from the Cleveland-based Federation For Community Planning's The Budget $cene In Ohio (November). The third is from reporting on New York State in the New York Times (11/20).

Progressivity: The District of Columbia Department of Finance And Revenue (Office of Economic and Tax Policy, 300 Indiana Ave., NW, Washington, DC 20001) prepares an annual comparison of burdens of major taxes on residents of the largest city in each state. The volume, Tax Rates And Tax Burdens In The District Of Columbia: A Nationwide Comparison, is useful in comparing individual taxes from state to state as well as in calculating progressivity.

Bookshelf: Significant Features is published by the Advisory Commission on Intergovernmental Relations (800 K St., Suite 450, Washington, DC 20575). The chart was developed by **Reports** from one of the many historical tables.

Answers To Quiz

(1) Fastest growing states in order have been Nevada, Alaska, Arizona, Florida, California, and New Hampshire.

(2) Other states with high median ages are in the Northeast (Connecticut, Pennsylvania, New Jersey, New York, Rhode Island, and Massachusetts). Other retirement destinations like Arizona, Nevada, and Texas are below the national average.

(3) The heavy manufacturing states are North Carolina, followed by Tennessee, Michigan, Indiana, and New Hampshire.

(4) In most states, the state raises just under half the money and local government just over half but Hawaii raises 71% while New York and New Hampshire are under 40%.

(5) State debt averages about $1,300 per capita with 20 states below $1,000. Twenty states could pay all their debt with half a year of their revenues and 40 states could make full payment with less than one year's revenues.

(6) New York taxes are second highest by this measure followed by Wyoming, Hawaii, Maine, and Minnesota.

(7) By either measure, Alabama, Arkansas, Mississippi, South Dakota, and Tennessee are low tax states. By the representative tax system (Table D-15 in Profiles), the Southern states rise in rankings compared to the other measures with New Hampshire getting the honors (stigma) for the lowest tax state, followed by Nevada, Florida, and Tennessee. New York is unambiguously the highest tax state by the RTS measure.

(8) The top states in federal grants per capita, Alaska and Wyoming, are the top states in revenue-raising ability.

(9) High spending states are New Jersey, New York, Connecticut, Alaska, and Rhode Island. Lowest spenders are Utah (56% of the national average), Idaho, Mississippi, Arkansas, South Dakota, and Alabama.

(10) High tuition-high spending per student strategies predominate in the Northeast where state support per pupil is the lowest. Midwestern states pursue this strategy a little less vigorously. States West of the Mississippi, with exceptions, follow the opposite strategy.

(11) Infant mortality is regional with the highest rates in Georgia, North Carolina, Mississippi, South Carolina, and Alabama.

Bonus Question: The combination of low law enforcement spending and low crime rates is found in North Dakota. Good guesses were Montana and Vermont. The trick is to export both criminals and victims, as crimes are reported by place of occurrence. This question is so hard that when tried on a panel of three experts, all three missed it and the **Reports** editor couldn't correctly remember the right answer.

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While some states are doing better than others, the falling national economic tide is lowering all boats. In preparing their new budgets, state officials will have to guess when economic recovery will begin. In some states, they are searching for a way state government can act to hasten recovery.

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Congress completed its work in 1991 with some boosts for state finances. The federal tax changes now being discussed would also affect state tax systems.

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December 1991 (Second Of Two December Issues)

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STATE ECONOMIC PERFORMANCE

Introduction

Governor announces recent job gains, says state development strategy working.

Study criticizes state's business climate, says development lagging.

Legislative leader predicts more budget cuts, maybe tax increases too, says problem is national economy.

These are examples of statements that imply something about how a state relates to other states. The statements beg for some measure of state performance relative to the nation and other states. For example, gaining 20,000 jobs isn't impressive if it's a lower percentage gain than the nation and 30 other states. Blaming budget cuts on national economic stagnation makes little sense if a state is far outperforming the nation.

How well are individual state economies performing? While there is no perfect way to answer this question with one statistic, the Index of State Economic Momentum is as close as anyone has come. The Index, which appears quarterly in **Reports,** measures a state's performance relative to the national average.

The Index Of State Economic Momentum

The Index is based on the most recent known changes in: (1) employment, (2) personal income, and (3) population. These changes for each state are related to the national average change for that measure. The differences are averaged for each state with the result expressed as the index number. The national index is 0.00, as the national average has no deviations from the national average.

Minor differences among states in economic statistics shouldn't be taken seriously. The population estimates are from a Census that may have overlooked five million people. The job data double-count some employees. The personal income statistics exclude the underground economy. But larger differences among states are significant, as evidenced by such indicators as how much budget trouble different states are experiencing.

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Winners And Losers

The latest Index appears as Table 1. The table shows an unusual distribution of states. The top 13 ranks are held by less populous states in the West. Most of the large industrial states are just above or below the national average. The bottom ranks are held by the New England states. Of the top 25 states, 23 are on, or West of, the Mississippi River. The exceptions are Florida, ranked 22nd, and Wisconsin, ranked 24th.

Table 1: Index of State Economic Momentum, September 1991

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	2.89	18	Mississippi	0.73		**United States**	**0.00**
2	Utah	2.54	19	Kansas	0.71	35	Delaware	-0.03
3	Nebraska	2.50	20	Minnesota	0.66	36	Virginia	-0.23
4	Hawaii	2.09	21	Wyoming	0.63	37	Georgia	-0.25
5	New Mexico	1.78	22	Florida	0.48	38	North Carolina	-0.26
6	Washington	1.66	23	Oklahoma	0.46	39	Missouri	-0.32
7	Arkansas	1.63	24	Wisconsin	0.44	40	Pennsylvania	-0.43
8	South Dakota	1.61	25	California	0.43	41	Maryland	-0.43
9	Oregon	1.54	26	West Virginia	0.35	42	Michigan	-1.12
10	Montana	1.53	27	Iowa	0.34	43	New York	-1.57
11	Idaho	1.52	28	South Carolina	0.30	44	New Jersey	-1.63
12	Arizona	1.50	29	Kentucky	0.28	45	Connecticut	-1.75
13	North Dakota	1.49	30	Indiana	0.25	46	Vermont	-1.78
14	Texas	1.38	31	Tennessee	0.20	47	Maine	-2.11
15	Colorado	1.23	32	Alabama	0.14	48	Rhode Island	-2.22
16	Alaska	1.01	33	Illinois	0.07	49	Massachusetts	-2.71
17	Louisiana	0.74	34	Ohio	0.03	50	New Hampshire	-2.76

What are the leading states doing right? For most of them, the answer is not so much that they have done something better than other states but that they avoided some problems plaguing the low-ranking states.

First, the low ranking states generally had overheated economies in the sense that construction and real estate prices had reached unsustainable levels. Because the economies of many Western and Southwestern states were depressed in the mid-1980s and haven't fully recovered, there was no remaining economic bubble to be burst in the 1990s. Arizona, Colorado, Louisiana, and Texas are examples. Second, the economies of the winning states are closely tied to resources -- oil and gas, timber, mining, and agriculture. These industries aren't all doing well, but overall aren't doing badly. Third, the economies of the losing states are closely tied to activities like manufacturing, finance, and defense procurement, which haven't been areas of strong growth.

Success Stories

There are significant success stories in the top-ranked states, although it is difficult to say how much of the success is attributable to state government policies and how much to other factors. Nevada leads the nation, though its margin above other states has declined from the September index, proving that no state economy can massively outperform the national average for long. Washington and Oregon, fueled by new industries like software and by in-migration, have resisted the recession, though Washington is now lowering its revenue expectations as recession reaches its economy. Hawaii continues to gain from foreign investment and tourism. Idaho and Utah have been steadily moving up in the Index.

The mystery is state economic performance that cannot be explained by regional trends, industry mix, or other variables. Three of the winners -- Arkansas, Nebraska, and New Mexico -- stand out. In the losers' column, there is no similar phenomenon. Each state ranks close to states that share its geography and economic characteristics.

Employment Change

From September 1990 to September of this year, the nation lost 747,200 jobs. The pace of job change among the states was uneven, as shown in Table 2. Twenty-eight states showed some gain in employment, though it was less than 10,000 jobs in all but nine states. Twenty-two states lost jobs, with the loss over 10,000 jobs in eighteen of them.

Table 2: Change In Employment (000), September 1990 And 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Texas	74.4	18	North Dakota	6.3	35	Tennessee	-15.3
2	Nebraska	39.2	19	Ohio	5.9	36	Missouri	-18.5
3	Arkansas	26.2	20	Montana	5.8	37	North Carolina	-20.6
4	Illinois	22.7	21	Washington	5.0	38	Maine	-20.7
5	Arizona	22.4	22	Oklahoma	4.8	39	New Hampshire	-24.4
6	Utah	22.3	23	Wisconsin	4.7	40	Maryland	-33.6
7	Colorado	22.2	24	Nevada	4.1	41	Virginia	-40.2
8	Louisiana	19.3	25	Iowa	3.8	42	Connecticut	-47.1
9	Oregon	17.5	26	West Virginia	3.8	43	Pennsylvania	-47.9
10	Minnesota	9.0	27	Wyoming	2.2	44	Georgia	-57.0
11	Kansas	8.9	28	Alaska	1.4	45	Florida	-67.1
12	South Dakota	8.9	29	South Carolina	-1.1	46	Michigan	-72.5
13	Idaho	7.8	30	Indiana	-2.9	47	California	-85.3
14	Kentucky	7.6	31	Delaware	-4.2	48	New Jersey	-103.9
15	Hawaii	7.2	32	Vermont	-7.1	49	Massachusetts	-152.0
16	New Mexico	7.0	33	Alabama	-12.7	50	New York	-276.2
17	Mississippi	6.9	34	Rhode Island	-14.2			

The economy lost about 0.7% of its jobs in one year, a time span when the economy under normal conditions would show an employment increase of at least 1%. The percentage change in employment over the latest year for which data are available for all 50 states is shown in Table 3.

Table 3: Percentage Change In Employment, September 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	5.31%	18.	Nevada	0.64%	34	Alabama	-0.77%
2	South Dakota	3.06	19.	West Virginia	0.60	35	Missouri	-0.78
3	Utah	3.03	20.	Alaska	0.56	36	Pennsylvania	-0.92
4	Arkansas	2.78	21.	Kentucky	0.51	37	Delaware	-1.21
5	North Dakota	2.35	22.	Illinois	0.43	38	Florida	-1.25
6	Idaho	1.95	23.	Minnesota	0.42	39	Virginia	-1.38
7	Montana	1.91	24.	Oklahoma	0.40	40	Maryland	-1.54
8	Arizona	1.50	25.	Iowa	0.31	41	Michigan	-1.83
9	Colorado	1.44	26.	Washington	0.23	42	Georgia	-1.89
10	Hawaii	1.38	27.	Wisconsin	0.20	43	Vermont	-2.74
11	Oregon	1.38	28.	Ohio	0.12	44	New Jersey	-2.84
12	New Mexico	1.21	29.	South Carolina	-0.07	45	Connecticut	-2.88
13	Louisiana	1.20	30.	Indiana	-0.11	46	Rhode Island	-3.15
14	Wyoming	1.06	31.	North Carolina	-0.65	47	New York	-3.36
15	Texas	1.05	32.	California	-0.66	48	Maine	-3.80
16	Kansas	0.82		**United States**	**-0.68**	49	New Hampshire	-4.75
17	Mississippi	0.73	33.	Tennessee	-0.69	50	Massachusetts	-5.14

Table 3 shows striking differences among the states. Fifteen states bucked the national trend with employment growth of 1% or more. Every one of them is West of the Mississippi River. Nebraska's economic performance was simply outstanding for a time when the rest of the nation was experiencing problems. All sectors of the Nebraska economy, from manufacturing to trade to services, gained in employment. Some formerly fallen stars -- states affected by the oil and gas depression of the mid-1980s -- are showing employment growth. Kansas, Mississippi, Louisiana, and Texas are all shown in the first column of Table 3. West Virginia, after a decade of depression, has no where to go but up and is now gaining jobs while the nationwide trend is downward.

The table suggests some new falling stars as well. Nevada's unsustainable growth has moved closer to the national average in job gains, with population and personal income growth likely to follow. California and Florida, which outperformed the nation through the 1980s, aren't maintaining this strength. While the most distressing employment losses are in the Northeast, which holds the bottom eight slots, some Southeastern states are now in the bottom third.

Personal Income Growing Slowly

While changes in job-holding are important indicators of state performance, there are many other factors affecting the income of state residents. They include compensation changes for those remaining in the same job, Social Security payments, earnings on investments, income of sole proprietors and partners, and government payments for employee retirement, agricultural price supports, and other programs. All of these are captured in the personal income measure shown in Table 4.

Table 4: Percentage Change In Personal Income, Second Quarter, 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	7.5%	18	Oregon	5.2%	34	Delaware	3.7%
2	Utah	7.4	19	Idaho	5.1	35	Ohio	3.6
3	New Mexico	7.2	20	West Virginia	5.0	36	Illinois	3.4
4	North Dakota	7.0	21	Kansas	4.9	36	Virginia	3.4
5	Montana	6.6	21	Oklahoma	4.9	38	Pennsylvania	3.3
6	Nevada	6.1	23	Alabama	4.7	39	Missouri	3.2
7	Washington	6.0	24	Tennessee	4.6	40	Maryland	2.9
8	Nebraska	5.8	25	Minnesota	4.5	41	North Carolina	2.7
8	Texas	5.8	26	Indiana	4.3	42	New York	2.3
10	Alaska	5.7	26	Iowa	4.3	43	Michigan	1.8
10	Arkansas	5.7	28	Wisconsin	4.2	44	New Jersey	1.7
10	South Dakota	5.7	29	Florida	4.1	45	Connecticut	1.3
13	Arizona	5.6	30	California	3.9	46	Massachusetts	0.8
13	Louisiana	5.6	30	Georgia	3.9	47	Maine	0.6
15	Colorado	5.5	30	Kentucky	3.9	48	Vermont	0.3
15	Wyoming	5.5	30	South Carolina	3.9	49	Rhode Island	0.1
17	Mississippi	5.3		**United States**	**3.7**	50	New Hampshire	-0.1

The bad news in Table 4 is not so much how individual states are doing relative to each other as how bad the national total is. For the economy simply to stand in place, maintaining the purchasing power of consumers, an increase larger than 3.7% would be necessary -- 3% or so to reflect inflation and 1% to reflect population growth.

About 20 states with about half the nation's population lost ground economically during the year covered by the table. Adding 2% for normal productivity growth produces a normal growth rate target of 6%. Only seven states made this target. Those seven are less populous states, including North Dakota which bounces around in income comparisons because of the timing of federal crop support payments.

Population Change

In extreme cases, population growth and economic development are related. West Virginia, which lost population in the 1980s, clearly didn't do as well as California and Florida with their rapid gains. But population gain isn't an unmitigated blessing. If there are more people but no more jobs, per capita income will drop and unemployment will rise.

Economists can't quite agree on the exact relationship between population and development. There are three basic ties, but forecasting the correlations with other factors like personal income isn't easy. First, population movements signal economic success and failure as people move toward job opportunities and away from areas where work they want can't be found. This explains why states like West Virginia and the Dakotas have been losing population and states like Washington have been gaining population. Second, some people move oblivious to job opportunities because they are in search of climate, low living costs, or other factors. Moves of retirees to states like Arizona, Florida, and Nevada are examples. These people bring their purchasing power with them, so their movement aids a state's economy. Third, rapid natural population growth will create a pool of workers seeking employment, generally at relatively low wages. That pool can itself attract economic development, which is much of the story behind the rapid growth of the economies of Idaho and Utah.

Table 5 shows the population changes used in the Index of Economic Momentum.

Table 5: Percentage Change In Population, 1989-1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	5.72%	18	Minnesota	0.85%	34	Rhode Island	0.20%
2	Washington	2.55		**United States**	**0.77**	35	Nebraska	0.19
3	Florida	2.37	19	New Mexico	0.73	36	Illinois	0.18
4	California	1.86	20	Wisconsin	0.72	37	Ohio	0.17
5	Oregon	1.83	21	Maine	0.66	38	New York	0.15
6	Idaho	1.31	22	Colorado	0.55	39	Pennsylvania	0.13
7	Delaware	1.22	23	Alaska	0.55	40	Connecticut	0.12
8	Hawaii	1.19	24	Tennessee	0.47	41	New Jersey	0.05
9	Arizona	1.19	25	Michigan	0.45	42	Massachusetts	0.00
10	Maryland	1.14	26	Missouri	0.41	43	Mississippi	-0.04
11	Virginia	1.09	27	Indiana	0.36	44	Montana	-0.13
12	Texas	1.07	28	New Hampshire	0.36	45	Oklahoma	-0.13
13	Georgia	1.05	29	Alabama	0.27	46	South Dakota	-0.14
14	Utah	1.00	30	Kentucky	0.22	47	West Virginia	-0.77
15	North Carolina	0.97	31	Iowa	0.22	48	Louisiana	-0.78
16	Vermont	0.90	32	Arkansas	0.21	49	Wyoming	-0.87
17	South Carolina	0.87	33	Kansas	0.20	50	North Dakota	-1.08

These data (which cover nine months as explained in the Technical Notes) reflect about a 1% annual increase in population nationally. They show massive differences among the states. Eight states lost population while many of the Northeastern and Midwestern states showed increases of less than half the national average. This slow growth correlates with several factors affecting state policy including: (1) a rising average age, (2) shrinking school enrollment, and (3) a decline in the 18-25 age group that is the major source of both college attenders and criminals.

Population Change And State Spending Pressure

The population growth statistics are indicators of demographic pressures on state spending. Table 6 shows that eight states account for about 75% of the total national population increase.

Table 6: Population Growth In Fast Growing States, 1989-1990

State	Population Increase (000)	Cumulative Percent Of U.S. Increase
California	542	28.7%
Florida	300	44.6
Texas	180	54.1
Washington	121	60.5
Virginia	67	64.0
Georgia	67	67.6
Nevada	65	71.0
North Carolina	64	74.4
United States	**1,890**	**100.0%**

The eight states shown as accounting for three fourths of the population increase now have only about a third of total U.S. population. There are significant policy differences associated with these demographic characteristics. One is concern with U.S. immigration policy and who bears the consequences of that policy. When California legislators and the governor met recently on the state's latest budget gap, they didn't agree on how to close it. They did agree to seek federal policy changes to ameliorate the impact of legal and illegal immigration on the state's budget. Much of California's rapid population growth is from immigration with easily identifiable impacts on state costs for elementary and secondary education, welfare, and health and social services.

The high growth states have serious infrastructure capacity problems. Traffic congestion in California and Houston are nationally-known. There are similar problems along Florida's coasts, in the Seattle area, and in Northern Virginia. There are school construction backlogs conservatively priced in the billions in California and significant problems in meeting demand at all levels of education in many of the rapid growth states. In the major metropolitan areas of the Northeast and Midwest, there are concerns about infrastructure, but key indicators of demand -- students in school, transit trips, vehicle miles traveled -- are often below what they were in peak years. As a result, maintenance is more a concern than expansion of capacity, though there is always someone interested in adding capacity.

Consumers Take A Holiday

As has been widely reported, the American consumer has been reluctant to spend. Nationally, retail sales growth has been an anemic 1% from the first nine months of 1990 to the same nine months of 1991. The state-by-state information, which is available only for 20 of the largest states, appears in Table 7.

Table 7: Retail Sales Growth, Nine Months, 1990 And 1991

State	Percent	State	Percent	State	Percent
Indiana	6.8%	Illinois	1.9%	New Jersey	-0.6%
Minnesota	5.8	Missouri	1.5	New York	-1.2
Florida	5.4	North Carolina	1.4	California	-1.5
Texas	5.3	Massachusetts	1.4	Wisconsin	-2.6
Ohio	4.6	**United States**	**1.0**	Pennsylvania	-2.9
Tennessee	2.4	Michigan	0.7	Virgiinia	-4.9
Louisiana	2.0	Maryland	-0.4		

These data, which are less reliable than information on employment and personal income, show extremely wide variations among the states. They confirm the other indicators in showing poor economic performance in the Northeast and California, but show somewhat more strength in the Midwest.

Housing Markets Weak Nationally

Housing and commercial construction are highly volatile components of state economies, particularly in states that have been experiencing rapid growth. Economic gains tend to create the expectation of more gains for those moving quickly. So speculative building is common in high growth areas. But when growth slows, builders and investors discover that the market may be overbuilt. In the adjustment phase, construction activity drops below what a "normal" pace might be as builders wait for demand to sop up what they call the overhang of empty office space and residential units. Table 8 reflects this phenomenon, which appears in the change in the issuance of permits for new residential units.

Table 8: Building Permits Growth, Nine Months, 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	North Dakota	38%	18	West Virginia	-6%	35	Delaware	-18%
2	Alaska	24	19	Wisconsin	-6	36	Illinois	-18
3	Utah	24	20	Kansas	-8		**United States**	**-19**
4	Colorado	22	21	North Carolina	-8	37	Massachusetts	-20
5	Louisiana	20	22	Connecticut	-11	38	Michigan	-20
6	Montana	20	23	South Carolina	-11	39	Virginia	-21
7	Hawaii	15	24	Alabama	-12	40	Rhode Island	-23
8	Oklahoma	11	25	Georgia	-12	41	Maine	-26
9	Idaho	10	26	New Mexico	-12	42	South Dakota	-26
10	Wyoming	7	27	Tennessee	-12	43	Florida	-28
11	Iowa	3	28	Minnesota	-13	44	Nevada	-28
12	Texas	2	29	Ohio	-14	45	New Hampshire	-28
13	Arkansas	-1	30	Mississippi	-15	46	Maryland	-29
14	Pennsylvania	-2	31	Nebraska	-16	47	Washington	-31
15	Arizona	-3	32	Kentucky	-17	48	New Jersey	-33
16	Indiana	-4	33	New York	-17	49	Oregon	-38
17	Missouri	-5	34	Vermont	-17	50	California	-40

The table deals with change in building activity, not total building activity. Many of the states that beat the national average -- such as Indiana, Missouri, and West Virginia -- don't have high levels of building activity by such measures as new units being built per 10,000 households or construction workers as a percentage of population. They do have stable activity, which is why they do better than the national average of a 19% decline. Most of the states in the center column of the table show this pattern of stability. The states with increases, as shown in the first column, are like those which lead the Index of State Economic Momentum, smaller states in the West.

The ten states with a drop of 25% or more have the most significance for state economies because the decline has been so dramatic in a market where housing construction has been a major force. California is at the bottom with a 40% decline. This means that roughly two out of every five people building new residential housing last year are out of a job this year. Similar declines will be affecting settlement attorneys, title searchers, drapery fitters, and others whose business is closely related to new housing construction. Florida and Nevada, two states that have escaped some of recession's impacts, are also near the bottom of the list.

The National Association of Home Builders sees rocky times ahead in home building. It figures the total construction job loss over the past two years has been 650,000. The unemployment rate among construction workers has reached 16%. The Association expects that homebuilding, as measured by Table 8, will get worse before it gets better.

THE ECONOMY AND STATE FINANCES

The New Year, Deja Vu All Over Again?

The condition of the nation's economy will play a critical role in state policy over the next several months. Practically all states face about the same problems.

Economic performance in the second half of 1991 has been worse than just about everyone expected. As a result, state spending is higher than expected. As a result, revenues are lower than expected. As a result, state finances are in worse shape than expected.

IF signs of recovery appear quickly, state elected officials will have a sporting chance of fulfilling their expectations for state policy and their commitments to the electorate. These often include not raising taxes, keeping pressures off local property taxes, and funding improvements in government activities like education. The situation may be tight, but the beginnings of recovery lend credence to policies, such as use of one-time revenues and delaying bill payments, that make little sense if economic stagnation will continue for a long time.

IF there isn't light to be seen at the end of the tunnel, there will be strong pressures for the election-year decisions elected officials least like -- tax increases and/or sharp spending cuts.

There Is No Sign On The Bottom

Economic forecasting is never particularly reliable. As California's legislative fiscal officer told legislators at a recent hearing, it is particularly difficult to forecast the timing of recovery from recession.

Errors in finding the economic bottom are hazardous for makers of state policy, no matter what type of error is made.

Erroneously forecasting turnarounds that don't occur leaves states long on spending and short on revenues. This is the circumstance in which officials of most states find themselves today.

Erroneously predicting that recovery won't occur leads to tax increases that are too large for what turns out to be the situation and to spending cuts that, in retrospect, are excessive. This happened in some states, particularly in the Midwest, in the 1981-1982 recession. State tax increases were bunched in December of 1982 and early 1983. They generated more revenue than needed to fund long-term spending levels and more taxpayer resistance than elected officials found acceptable. Some were rolled back.

The Budget Outlook

In most states, the outlook is for no costly new initiatives in the new FY 1993 budgets. For schools, this means inflation adjustments at best, with new education quality moves confined to those involving little cost such as school governance reforms and student testing. Past legislation calling for more than this may not be funded. For higher education, this means another year, like FY 1992 (Issue 23), with state support below or at inflation.

For welfare, it means little or no increase in payment levels. For welfare and Medicaid, it means no increase in eligibility except as required by federal law. For corrections, it means current service funding in some states and attempts to reduce growth in inmate populations by alternative sentencing and early release in others. For local aid, it means no new programs and some pressure to cut existing ones. For all other programs, it means current service funding, often adjusted by small across-the-board percentage cuts.

For taxpayers, prospects for major tax relief are dim. Less costly relief measures will be considered. Examples are industrial development incentives, business research and development and investment credits, and attempts to lower taxes of low-income wage earners. Some could be adopted, but not many. Election-oriented legislators will offer many more costly relief measures -- a penny off the sales tax, new sales tax exemptions, new income tax credits -- but these are likely to end their legislative careers in committee.

There will be exceptions. Some states, such as Kansas and Tennessee, may increase taxes enough to fund new initiatives just as Pennsylvania did this year. Litigation on school finance could force action in some states. But, in general, the situation will be tight.

States Bucking The Trend?

Will there be exceptions because some state economies are clearly outperforming the nation? Probably not many, as suggested by the new Index of State Economic Momentum (Table 1).

Only four states are 2% or more above the national growth rate in the Index. Each has its own problems. Nevada (ranked #1) is paying the price of the rapid population growth that leads to its top ranking. Its lucrative gambling base is being spread over a larger and larger population, which increasingly includes families with children in school and looking for college openings. State taxes were raised this year. A recent review of state finances in the 1990s predicted more increases would prove necessary. Utah (#2) has the nation's highest birth rate and faces resulting needs for school construction and operations spending. Part of its economic success is based on a reasonably well educated and motivated labor force, but it will likely use its prosperity to try to keep education spending, as indicated by class sizes, from being too far out of line with other states.

Nebraska (#3) has a unique set of problems related to property taxes, particularly personal property, that may result in a substantial overhaul of its tax system. If relative prosperity generates extra revenues, facilitating that change will probably get first call on its resources. Hawaii (#4) is experiencing two major problems associated with its prosperity: (1) congestion in the Honolulu area and (2) housing prices that are out of sight for many of its citizens. Expensive plans for dealing with one or the other will probably take priority over decreasing tax burdens.

State Policies To Stimulate The Economy

> *I think he's sensing that the taxpayer, the citizen, wants government to show some leadership in the area of economic recovery. He's talked about it more and more in the last few weeks.*

This comment about a governor's thinking made by his communications director is typical of the discussion in state capitols about what to do about the recession. But Minnesota's Governor Carlson, like other governors, finds his options are limited. Traditional economic stimulus measures involve putting more purchasing power into the hands of taxpayer/consumers by lowering taxes or raising spending. Balanced budget requirements force states to take away in higher taxes (or lower spending) what they put in by higher spending (or lower taxes).

Revenue neutral plans, such as raising income taxes on the rich to pay for tax relief for middle income taxpayers, may be desirable on other grounds but have little stimulative effect. Such plans, suggested by some lawmakers in Congress and the Minnesota legislature, will have slight stimulus because the savings rate is higher for higher income people, so the tax change will draw some money from savings to spending.

The options with the most impact spend money raised from borrowing and/or cash reserves. In many states, there has been discussion of accelerating highway and other construction financed by bond issues. There has been some acceleration, but until Congress acted on highway legislation it was difficult to accelerate highway projects.

States As The Economic Villain

State governments themselves aren't adding to consumer confidence. The normal course of state budget balancing activities leads to many bad-news headlines.

State faces deficit, tax increases discussed.

Layoffs, payless paydays, threatened in state government.

School district faces cutbacks, layoffs, as state aid reduced.

Nursing home threatens shutdown as state payments delayed.

No raises next year, governor warns state employees -- mayor cautions city workers.

This kind of news tends to undermine confidence of those who are not directly affected as well as those who are. For those who are affected and in turn those affected by them, the results are comparable to similar moves in the private sector. Layoffs and decisions not to fill vacancies create the same income losses whether the employer is in the private sector, the state, or a local government affected by state aid changes. Even welfare matters. As Washington's chief economist recently pointed out, "A dollar spent in the grocery store by a welfare mother is no different than a dollar spent by a Boeing worker."

FEDERAL IMPACTS ON STATE FINANCES

Introduction

By the standards of the past three decades, state officials continue to experience a period of extraordinary stability in federal policies affecting the management of states.

Overall Policy And Economic Management

The work of state officials would be easier if the federal government solved the nation's problems -- providing affordable and accessible health care, stemming the flow of illegal drugs, reducing crime, reducing teen pregnancy and dependency, and dealing with AIDS. If the federal government isn't to solve these and other problems directly, many believe it should provide more aid to state and local governments being expected to solve them. State officials of all political persuasions often suggest more federal action. Governor Cuomo's case is one of the broadest and best known. There are many narrower ones, such as the bipartisan California position that the federal government should bear a greater share of the costs of its immigration policies.

State finances are largely at the mercy of the success of national economic management. Against a standard of sustained 3% growth in the national economy, federal economic management is the cause of a major part of current state fiscal difficulties and more successful economic management would solve most of the problems.

In these broad aspects, there are few state problems that can't be blamed on the federal government. From time to time, state officials do lay this blame. But in contrast to the 1960s, state officials aren't waiting for federal action. Much of their immediate interest is in less broad aspects of federal policy like taxes, grants, Medicaid rules, and mandates.

Possible Federal Tax Policy Changes

Introduction: In the early 1980s, there was great uncertainty about federal tax policy. Changes were frequent and future policy highly uncertain because of pending tax reform legislation. Following enactment of the federal tax reform legislation of 1986, there has been a broad consensus that major federal tax issues shouldn't be reconsidered anytime soon. The argument is that stability in tax policy has so many benefits that it should be preferred for a time to any changes no matter how meritorious. This view is so widely held that legislation to extend certain expiring provisions (e.g., low income housing credit and mortgage revenue bonds) was enacted quietly this year in the closing minutes of the session to discourage opening up other policy issues.

In the discussion of how to deal with recession, many Members of Congress have offered tax cutting ideas. The President is expected to do so in January. Prospects are uncertain. First, there is still reluctance to open complex provisions of the tax code, such as treatment of income from investments. Second, there is reluctance to experience revenue loss given a deficit involving $1,000 in new federal debt per American per year. Third, the President and Democrats in Congress may be unable to agree on what changes to make. In general, the proposed changes wouldn't cause major changes in state tax laws or revenues, but would have some impacts as described below.

Business Tax Changes: The discussion of business tax incentives has centered on those, like an investment credit, that are taken after the basic tax liability is calculated. States already have a pattern of corporate tax credits bearing little resemblance to federal credits. They wouldn't necessarily make the same changes as those made at the federal level. But proposals to allow faster write-off (depreciation) of business machinery and equipment would reduce taxable income, at least in the short term, and thus reduce corporate income tax revenue of state and federal governments. When a comparable change was made a decade ago, some states conformed immediately, but many delayed conformity to cushion the revenue loss.

Tax Credits For Individuals: One plan, proposed by House Ways and Means Chairman Rostenkowski, would provide a credit of 20% of federal payroll taxes for Social Security and Medicare with a limit of $200 per individual. Senate Finance Chairman Bentsen would give a $300 per child credit. These would have no direct effect on state tax policy or revenues.

Rate Changes: Excepting a few states like Vermont that base state tax liability on federal liability, state taxes are independent of federal tax rates. So plans, like Rostenkowski's, that would raise top bracket rates would have no impact on states.

Retirement Accounts: Several plans are designed to encourage individual savings in IRAs and other retirement accounts. One mechanism is to reduce the limits on contributions (e.g., amounts, who can contribute) which would reduce taxable income and thus tax revenue. Another is to expand the circumstances under which money can be taken out without penalty for early withdrawal. Both approaches would affect the state as well as federal tax base.

Capital Gains: The tax reform legislation ended a decades-old pattern of lower taxes on capital gains than other income. Some people argue the change reduced incentives to invest and American productivity and competitiveness. The likely change is to reduce the amount of gain that is taxable, which would reduce the income tax base of conforming states. A few states (e.g., Wisconsin) retained special capital gains treatment and wouldn't be affected.

Passive Losses: One of the major changes in the 1986 reform legislation was to prevent the offset of income by real estate and other tax shelters (passive losses). This decision would be altered by some of the proposals, cutting taxable income and thus state as well as federal revenue.

Interest Income: One of the proposals would allow exclusion of interest income up to $225 for individuals, leading to a loss for both federal and state treasuries.

Possible Major Spending Changes

The continuing deterioration of the political and economic situation in the Soviet Union is leading many Members of Congress to eye the prospects for a defense dividend that might result from a faster scaledown of defense spending than is contemplated by the multi-year agreement on the federal budget. It isn't obvious that such a reduction in defense spending will occur or that, if it does, the resources would be redirected to programs directly affecting state policy. Other alternatives include deficit reduction, federal tax reduction, and direct federal outlays for such functions as health research, foreign aid (including aid to the Soviet Union), pollution control and clean up at federal facilities.

State and local governments have fared well recently, if this can be measured by growth in federal grants. In the third quarter of 1991, federal grants to state and local governments were being made at an annual rate of $152 billion a year. This was up $22.2 billion from the same quarter a year earlier, an increase of 17.1%. At the same time, overall federal spending only increased 5.2%. Medicaid was the driving force in the rapid grant increases. The results in the new federal budget are indicated by Table 9 which lists programs of interest to states with FY 1992 funding in excess of $1 billion.

A compilation of grant funding by Federal Funds Information for States shows grants rising to $185.4 billion in FY 1992, a rise of $27.2 billion from $158.2 billion in the current year. This increase of 17.2% is well above what state and local governments will raise for themselves (6-8%) and likely inflation (3-5%).

Table 9: Major Federal Programs Affecting State Governments
FY 1992 Appropriations ($ billion) And Change From FY 1991

Program	Amount	Percent Change
Medicaid Benefits And Administration	$68.1	29.5%
Food Stamp Benefits	20.7	14.9
Highways (Obligation Ceiling)	16.8	15.9
Welfare (AFDC) Payments	12.2	7.4
Compensatory Education (Chapter 1)	6.8	10.0
Community Development Block Grants	3.4	6.3
Social Service Block Grants	2.8	0.0
Women, Infants, and Children (WIC) Program	2.6	10.6
EPA Water Pollution Construction Grants	2.4	14.3
Head Start	2.2	12.8
Special Education Basic Grant	2.0	6.6
Low Income Home Heating Assistance	1.5	-6.8
Alcohol, Drug Abuse, and Mental Health Grant	1.4	7.2
Vocational and Adult Education	1.4	14.8

If state and local officials were given the option to spend any defense dividends, they would be able to develop a long list of desired programs. Past policy pronouncements and current fiscal circumstances suggest that state officials would emphasize means-tested programs. Federal assumption of health care responsibility would probably top the list, starting with long-term care (nursing homes, hospices, home health care) for the aged. Federal acceptance of a cost item of this magnitude would, at least for a time, remedy the tight fiscal condition in which most states now find themselves. However, relief from this source isn't being assumed in state budgets.

Mandate Relief

Quantifying the impact of federal mandates on state and local budgets remains a formidable task, though NCSL is now quantifying the cost impacts of proposed new federal mandates. The most visible mandates are the most recent ones because they are discussed in connection with state budgets. Major examples include: (1) the extension of AFDC eligibility to two-parent households, (2) the extension of Medicaid to certain pregnant women and young children, (3) Medicaid coverage of costs of low-income persons over 65 for costs not covered by Medicare, (4) Medicaid reimbursement rates for hospitals and other health care providers, and (5) rights of institutionalized persons enforced through litigation involving prisoners, mental health patients, and others.

In terms of total cost impact, some less discussed mandates adopted years ago but now having their greatest effects may be more significant. Water pollution control standards, particularly separation on storm and sanitary sewers, are one example. Laws affecting solid waste disposal and landfills are also big money items.

These costs are local rather than state, but many states have agreed to share them. Fiscal circumstances in some states, such as Massachusetts, have put limits on state ability to provide the cost sharing previously promised for local projects.

Medicaid Finance

Not everyone was equally thrilled by the compromise enacted by Congress on Medicaid bootstrap financing. NGA's executive director called it a victory for the states. NCSL's Federal Update (12/6) noted the settlement was "prompted by the willingness of the National Governors' Association to compromise state taxing authority and disproportionate share hospital payment practices."

The assessment in part depends upon the starting point for analysis. Assessed against state practices as they existed in the summer of 1991, the settlement provides major new sources of fiscal flexibility and budget relief for all but a few states. Assessed against present state practices, it provides new sources of fiscal relief for most states and protects the fiscal flexibility already seized by most of the others. But assessed against the potentials if every state did what the most aggressive states have done, there is a substantial loss in potential flexibility.

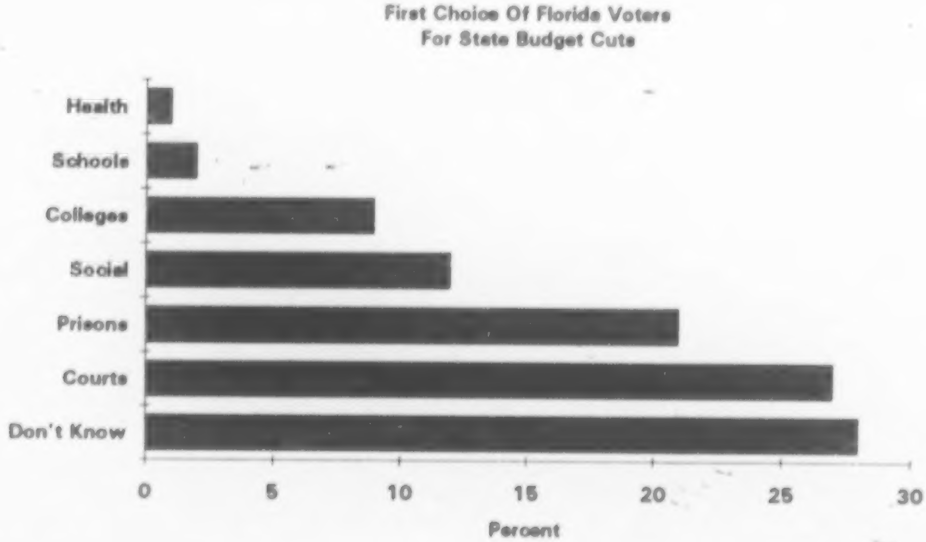
The immediate news is all good. Many states used bootstrap financing to avoid or minimize sharp cuts in their FY 1992 budgets, accepting risks of federal disallowance so great that other states were reluctant to try the tactic. The aggressive strategy is working for FY 1992. The FY 1993 budgets can be expected to use this flexibility again, thereby mitigating budget pressures from Medicaid.

PUBLIC OPINION

Public opinion polls continue to show that the public likes spending but doesn't like taxes. But when it comes to closing budget gaps, the combination of lower spending and higher taxes seems to have much appeal.

In Florida, there has been considerable fanfare about budget cuts. The FY 1992 budget was viewed as tight before it was enacted. Press reports were filled with dire predictions of cutbacks. In the fall, the governor announced that the FY 1992 budget was out of balance by over $600 million. He endorsed 5.4% cuts in many programs. Subsequently, Florida courts decided the action exceeded his power, so a special legislative session is being held to deal with cutbacks.

In October, Florida voters were asked how state government should deal with its money shortage. Only 11% chose raising taxes, 34% said cut spending, 46% picked a combination of the two, and 9% didn't have an opinion. Respondents were asked to think about their local school system if faced with a 10% cut. Only 14% said "the only way it can do so is by laying off teachers -- and hurting the overall quality of education." Nine percent weren't sure and 77% picked the statement: "My local school system could easily cut its budget by 10% -- without hurting the overall quality of education -- by laying off administrators instead of teachers." On state cuts, there was a clear preference as shown in the graph. The question was, "If the state must cut, which area would you cut most?"



About half the Florida voters said the possibility that they would support higher taxes was increased by hearing of the budget cuts. But only 20% favor an income tax. This percentage rises to 44% if the income tax would only be on income over $75,000 a year. Doing something specific with new taxes was a hit with Maryland voters in a survey sponsored by the Maryland State Teachers Association. A tax increase to close the budget shortfall got about one-third support, but 76% support appeared for a tax increase associated with education.

The Iowa Poll has established that 56% of the state's voters disapprove of the laying off of state workers, but only 31% support a tax increase to avoid layoffs. Iowa has been cutting state support for universities. To address the resulting budget problems, only 13% favor substantial tuition increases and only 22% favor elimination of academic programs. A salary freeze splits the electorate. More state tax support is favored by a two-to-one margin.

COMPARING AFFLUENCE AMONG THE STATES

Despite their economic problems, Northeastern states continue to lead the nation in affluence in 1990. But they may soon see their lead erode.

Per Capita Income Differences

As shown in Table 10, only three states -- Connecticut, New Jersey, and Massachusetts -- were 20% or more above the national average in per capita income. Six states were more than 20% below average. At one time, states of the Old South monopolized the bottom positions. Now three of the bottom five positions are held by states outside the South. New Mexico and, especially, Utah are there because of rapid population growth, the denominator in per capita income. West Virginia's problem is low income, not population growth.

Table 10: Per Capita Personal Income 1990

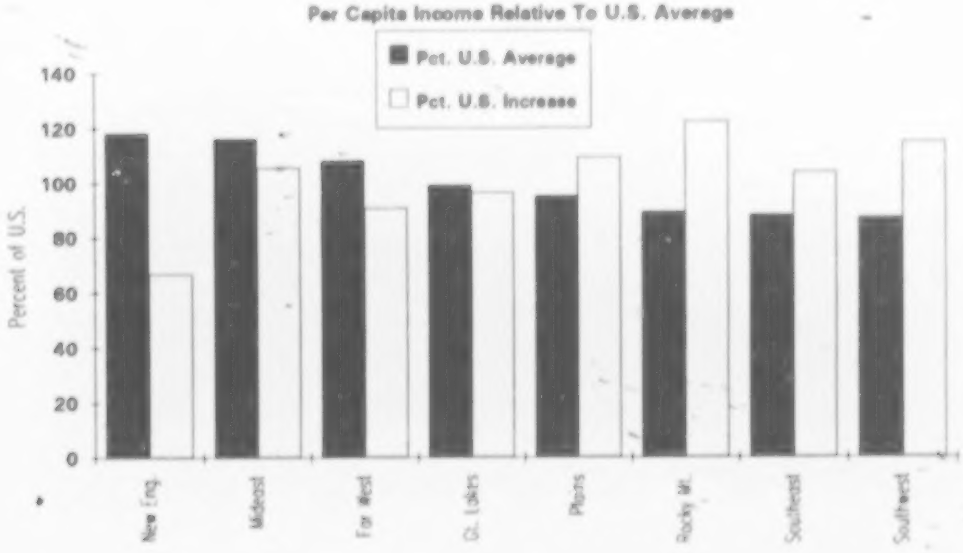
Rank	State	Amount	Pct. of US	Rank	State	Amount	Pct. of US
1	Connecticut	$25,484	136%	26	Missouri	$17,472	93%
2	New Jersey	24,936	133	27	Iowa	17,218	92
3	Massachusetts	22,569	121	28	Oregon	17,196	92
4	New York	22,086	118	29	Maine	17,175	92
5	Maryland	21,789	117	30	Georgia	17,049	91
6	Alaska	21,688	116	31	Indiana	16,890	90
7	New Hampshire	20,827	111	32	Texas	16,716	89
8	California	20,677	111	33	Wyoming	16,314	87
9	Illinois	20,419	109	34	North Carolina	16,293	87
10	Hawaii	20,356	109	35	Arizona	16,012	86
11	Delaware	20,022	107	36	Tennessee	15,866	85
12	Virginia	19,671	105	37	South Dakota	15,797	85
13	Nevada	19,035	102	38	Oklahoma	15,457	83
14	Colorado	18,890	101	39	Montana	15,270	82
15	Rhode Island	18,802	101	40	Idaho	15,249	82
16	Washington	18,775	100	41	North Dakota	15,215	81
17	Minnesota	18,731	100	42	South Carolina	15,151	81
	United States	**18,691**	**100**	43	Alabama	15,021	80
18	Pennsylvania	18,686	100	44	Kentucky	15,001	80
19	Florida	18,530	99	45	Louisiana	14,542	78
20	Michigan	18,360	98	46	New Mexico	14,265	76
21	Kansas	18,162	97	47	Arkansas	14,188	76
22	Ohio	17,564	94	48	Utah	13,993	75
23	Wisconsin	17,560	94	49	West Virginia	13,755	74
24	Nebraska	17,549	94	50	Mississippi	12,823	69
25	Vermont	17,511	94				

Only five states are from 10% to 19% ahead of the national average while 13 states are this far behind the national mark. Twenty-two states are within 10% of the national average as calculated by the Department of Commerce.

Reducing Per Capita Income Disparities

In the American economy, people are free to move to the most economic opportunity they can find and businesses and thus jobs are free to move to the places offering the best opportunities to hire workers. As a result, a state shouldn't be able to stay far above or below national averages for long, at least this is what the "convergence theory" holds. By that theory, wide differentials among states will tend to disappear over time.

Last year was an illustration of convergence at work. The chart below shows the regions of the U.S. with the solid bar representing their per capita incomes in 1990 as a percent of the national average. The other bar reflects the percentage increase in per capita income of that regional relative to the national percentage increase. For example, New England was 18% above the national average, but its growth of 3.6% was well off the national pace of 5.4%. The chart shows a definite tendency for the best growth to be found in regions with the lowest incomes. Such a pattern, if repeated year after year, would draw all the states toward the national average.



Migration Of The Affluent

Twenty-three years ago Allied Van Lines decided that its records on interstate moves provided a significant demographic and economic indicator. The moves in 1990 provided two firsts. For the first time, Florida dropped out of Allied's category of magnet states, which it defines as having at least 55% of all moves into the state. California had more outbound than inbound moves in 1990, also for the first time since the recordkeeping began. The information for all 50 states appears in Table 11.

Table 11: Percentage Of Allied Van Line Moves That Were Inbound, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	69.0%	18	Texas	54.7%	34	Ohio	46.6%
2	Oregon	66.7	19	Utah	54.3	35	Oklahoma	46.0
3	Maine	66.5	20	Missouri	53.2	36	Virginia	45.5
4	Hawaii	61.7	21	Arkansas	52.3	37	Illinois	45.4
5	Georgia	61.6	22	Delaware	52.3	38	Louisiana	45.3
6	Washington	61.4	23	Idaho	52.2	39	Indiana	45.2
7	Vermont	59.7	24	Kentucky	51.1	40	Michigan	45.1
8	Alaska	59.6	25	Tennessee	51.1	41	Pennsylvania	44.6
9	South Carolina	59.2	26	Minnesota	50.8	42	California	44.1
10	North Carolina	58.1	27	Wisconsin	50.6	43	Wyoming	42.4
11	Montana	57.8	28	Nebraska	50.4	44	Massachusetts	41.9
12	Colorado	57.3		**United States**	**50.0**	45	New Jersey	41.0
13	New Mexico	56.1	29	Kansas	49.8	46	New York	41.0
14	Alabama	55.9	30	West Virginia	49.8	47	New Hampshire	40.9
15	Arizona	55.9	31	Mississippi	48.8	48	South Dakota	40.9
16	Rhode Island	55.3	32	Iowa	48.5	49	Connecticut	39.8
17	Florida	54.8	33	Maryland	48.2	50	North Dakota	28.1

The data show a correlation with the Index of State Economic Momentum (Table 1), but not a perfect one. Nevada leads the Index and leads in the percentage of inbound moves. Other states showing a high percentage of inbound moves do well on the Index, such as Oregon and Hawaii. But Maine and Vermont are high in inbound moves but low on the Momentum Index.

Farm states losing population overall, like the Dakotas, have low rankings in Table 11, as would be expected. But it also shows relatively dramatic losses in other states, particularly Connecticut, New Hampshire, and Massachusetts. Large industrial states -- such as California, Illinois, Michigan, and Pennsylvania -- all are exhibiting some loss of population through Allied Van line moves, but the loss isn't dramatic.

Movement Of Retirees

Retirees have long been a major factor in Florida's growth and have something to do with Nevada's Number One ranking on the Index of State Economic Momentum. Considerable effort is being made by some states to draw retirees. In other states, there is debate over whether state policies are driving retirees away. For example, whether to eliminate an estate tax larger than those of most states is a current issue in Massachusetts.

The persons who will reach age 65 during the 1990s were born in the Depression Era when birth rates were low. So despite greater longevity, the number of persons aged 65-74 will grow by only 3% in the first half of this decade. It will fall by about the same percentage in the second half. As a result, any state expecting to get much of a gain in population in this age group will need to pick up population from other states.

A recent projection appearing in American Demographics (December) indicates that the largest gains in population of this age group during the 1990-1995 period will be in two states. Of the estimated growth of 671,527 people, California is predicted to get 216,069 and Florida to get 172,297. But when the increases are put in percentage terms, some other states show significant gains, as reflected in Table 12. A dozen states show losses in this age group.

Table 12: Estimated Percentage Growth In Population Aged 65-74, 1990-1995

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	18.0%	18	Virginia	4.3%	34	Kansas	0.6%
2	Florida	12.3	19	Utah	3.5	35	Wisconsin	0.1
3	Arizona	11.4	20	Tennessee	3.3	36	New York	0.0
4	Hawaii	11.1	21	Texas	3.3	37	Ohio	0.0
5	California	11.0		**United States**	**3.0**	38	Pennsylvania	-0.1
6	New Hampshire	9.3	22	Alabama	1.8	39	Illinois	-0.2
7	Washington	8.0	23	Rhode Island	1.8	40	Mississippi	-0.2
8	Delaware	7.9	24	Arkansas	1.7	41	South Dakota	-0.5
9	Georgia	6.0	25	Minnesota	1.5	42	Nebraska	-0.7
10	Alaska	5.9	26	Idaho	1.4	43	Kentucky	-1.1
11	New Mexico	5.9	27	New Jersey	1.3	44	Montana	-2.1
12	Vermont	5.6	28	Massachusetts	1.1	45	Iowa	-2.7
13	North Carolina	5.5	29	Indiana	0.9	46	Louisiana	-3.0
14	South Carolina	5.4	30	Connecticut	0.8	47	Oklahoma	-4.1
15	Maryland	5.3	31	Missouri	0.8	48	West Virginia	-6.3
16	Oregon	4.8	32	Colorado	0.7	49	North Dakota	-7.1
17	Maine	4.7	33	Michigan	0.7	50	Wyoming	-7.5

TECHNICAL NOTES

Index of State Economic Momentum: The Index is published quarterly in **Reports**, with the previous one appearing in Issue 18. The index is the average of three differences -- the difference between each state's change and the national change in population, personal income, and employment. Data on each of the components appear in this issue. Employment data are published monthly by the Bureau of Labor Statistics. Personal income data are published quarterly by the Bureau of Economic Analysis of the Commerce Department.

Population: Between the 1980 Census and the 1990 Census, the Census Bureau has issued annual estimates of state population. These have been used for many purposes including private and public sector analyses of markets and programs, administration of federal grants, and the Index of State Economic Momentum. The count of the 1990 Census was inconsistent with the earlier estimates, showing implausible growth and decline for some states between the last estimate and the count. So Census retrospectively redid the estimates, providing the data used in the tables and in preparation of the Index. The shift to the newer estimates affects the Index rankings of the states compared with the Index last quarter. The shifts don't appear to have been systematic. That is, they don't uniformly increase the rankings of fast or slow growing states, or states in a particular region.

Retail Trade: The Census Bureau retail trade numbers are widely used as a national economic indicator, although some economists have doubts about the accuracy of the series on a national basis. These concerns are magnified for the state-by-state data presented in Table 7.

Building Permits: The issuance of building permits doesn't mean that construction will follow, as builders may not use permits in a soft home building market. But covering nine months, as Table 8 does, should overcome criticism of use of this economic indicator.

Federal Impacts: Table 9 is taken from NCSL Federal Update (12/6). Some of the programs included, such as Food Stamp benefits, aren't counted as grants to state and local government. **Reports** took all programs listed by NCSL with FY 1992 funding over a billion except the new housing program (HOME Investment Grants) which rises from zero to $1.5 billion but replaces a variety of other housing activities being eliminated or cut.

Public Opinion: The Florida poll was sponsored by the Miami Herald which reported it on October 18.

VOLUME 10 ISSUE 1

SPR

STATE POLICY REPORTS

IN THIS ISSUE

State fiscal situations now look poor throughout the nation, as expected recoveries in the economy and state revenues fail to appear. The result is likely to be another year of austere budgets.

- Another Tight Year p. 2

Some experts expect the fiscal problems to last a decade. California projections confirm national predictions. The predictions suggest a worse environment in the 1990s than in the 1980s for taxpayers and state-funded activities, particularly education.

- The Perpetual Fiscal Crisis? p. 6

In making fiscal adjustments, states are hurting some group: the poor? the middle class? Not everyone agrees. A new report suggests the poor, but indicates major differences among states.

- Sticking It To The Poor p. 10

While predictions of tight budgets roll in, so do data on past spending and tax burdens. There is a new list of which states have the highest and lowest taxes and spending. Some states have shown increases well above the national average. Overall state financial patterns in FY 1990 differed little from those a year earlier.

- Spending And Tax Levels p. 14

"Balance" in state tax systems isn't found in all states, but there are strong pressures for states out of line to move closer to national patterns.

- Balance In State Tax Systems p. 20

Miscellany covers college savings programs, health care, state and local fiscal interactions, urbanization, and more. Technical notes detail sources and calculations.

- Miscellany p. 21
- Technical Notes p. 24

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January 1992 (First Of Two January Issues)

ANOTHER TIGHT YEAR

Introduction

With no sign that the economy has hit bottom, state finances continue to deteriorate. The typical state's budget for this year (FY 1992) is in worse shape than when enacted. The reasons: (1) balances coming out of FY 1991 that were below expectations, (2) revenues, particularly in the sales tax, running below predictions, and/or (3) higher-than-expected spending for Medicaid and often other programs such as AFDC and corrections. The same factors causing problems in FY 1992 are expected to cause imbalance in FY 1993 unless taxes are increased or current spending patterns sharply curtailed. While not all states exhibit the typical pattern, most do.

Current Year Problems

There are current year shortfalls in over half the states. The worst cases are in large states like California, Florida, Illinois, Michigan, New Jersey, and New York. The exceptions are in sparsely populated states in the West. Probably, three-fourths of the nation's population lives in states with major budget problems this year.

Solving Current Year Problems

Although notions of sound state financial management and, often, state law call for correction of imbalances during the year, this isn't always happening.

In some states, the likely shortfall hasn't officially been recognized by the executive branch, so there is no legal requirement to deal with the problem. Examples are Illinois, Michigan, and New Jersey.

In some states, such as Alabama and Arkansas, corrective action is nearly automatic as spending is proportionally reduced to conform to revenues (Alabama) or reduced pursuant to a plan incorporated in the appropriations legislation (Arkansas).

In many states, the governor has sought to take corrective action, but success has been limited. In two states (Florida and Montana) where the legislature has given the governor responsibility and power to make a wide range of cuts, state courts have determined the action to be an unconstitutional delegation of legislative powers. These governors have had to turn to their legislatures for approval of proposed cuts.

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The power of the governor alone to make cuts in other states is often limited by special requirements mandating that any cuts be equal across-the-board, exempting certain programs, or making other restrictions. In all but a few cases, the executive power to make reductions doesn't extend to modifying statutes dealing with such subjects as distribution formulas for school aid and entitlements to state aid for legally designated groups.

Collective bargaining agreements also constrain executive -- and in some cases legislative -- power to make changes affecting previously negotiated agreements with employees. California and Connecticut are major examples. In these states, assumptions about pay and other compensation built into the enacted budgets aren't being realized.

As a result, many governors have turned to the legislatures to adopt their budget cutting recommendations. This mechanism was used effectively late in 1991 in Florida, Georgia, and Maryland, though the legislative results weren't identical to the governor's recommendations. Going to the legislature hasn't been successful in other states. In California, Maine, and New York, governors and legislative leaders have been unable to agree on actions to bring the current budget into balance. The passage of time without action is particularly critical in New York where the fiscal year ends in March. The consequences have been noticeable. California has lost its Standard & Poor's AAA bond rating. Governor Cuomo attributed his decision not to run for President to inability to reach agreement with legislative leaders on budget-balancing measures.

Things Are Worse Than They Seem

Current shortfalls are more serious than information available to the public shows. There is always a lag between economic events, such as job loss, and their reflection in state revenues. There are also lags between tax collections and reporting of collections and between reporting of collections and revisions of revenue estimates. In addition, new revenue and spending estimates are not announced from October through December in many states. Instead, they are part of budgets released in January.

Sneaky Bad News In Recession: In persistent recession conditions, obscure features of tax systems and spending patterns compound bad news and often deliver it at awkward times. When a worker is out of a job for a quarter of the year, the loss of state income tax revenue is much more than one-fourth. The untaxed portion of income represented by personal exemptions and deductions remains unchanged, so the entire loss affects the taxed portion of income. The effect is exaggerated in states with graduated rates. Recession disproportionately affects corporate profits, with effects on state revenue greatly amplified by loss carryforwards and carrybacks. Property tax delinquency increases which in some states enters school aid formulas to reduce required local tax effort and increase the state aid entitlement.

The statistics that are known on national economic performance and tax collections, and budget estimates in states where they are made in December, all suggest more bad news is on the way.

More Bad News For Next Year

The history of post-World War II recessions suggests that this one should be about over. But economists have proven no more apt at predicting recovery than at predicting recession, with a historical tendency to miss both turning points. This pattern may well be repeated in the revenue estimates for the FY 1993 budgets in most states. This would mean a dim outlook for FY 1993 standing alone and an even dimmer one as the problems of FY 1992 roll into FY 1993. The problems are seen in the form of low or negative balances, unpaid bills, and one time balancing devices that must be replaced with real revenues or spending cuts in the following year.

Nationwide, state tax cuts aren't in the cards. The exceptions are likely to be minor adjustments in the name of economic development, such as expanding enterprise zones, and lowering one tax by increasing another.

In the incremental world of budgeting, *increases* will be a No-No. So the pressures will be strong to avoid increases in: (1) employee pay, (2) outlays for non-cash compensation such as the employer share of health insurance costs, (3) welfare cash payments, (4) school aid, (5) general local aid, (6) reimbursement rates for health care providers, and (7) all other reimbursement rates such as those for foster parents, local jails that take state prisoners, day care, home health care, and social services. Increases in agency budgets for any reason will come under more than the usual scrutiny. New Initiatives will also be a No-No.

The Budget Outlook

In most states, the outlook is for no costly new initiatives in the new FY 1993 budgets. For schools, this means inflation adjustments at best, with new education quality moves confined to those involving little cost such as school governance reforms and student testing. Past legislation calling for more than this may not be funded. For higher education, this means another year, like FY 1992 (Issue 23), with state support below or at inflation.

For welfare, it means little or no increase in payment levels. For welfare and Medicaid, it means no increase in eligibility except as required by federal law. For corrections, it means current service funding in some states and attempts to reduce growth in inmate populations by alternative sentencing and early release in others. For local aid, it means no new programs and some pressure to cut existing ones. For all other programs, it means current service funding, often adjusted by small across-the-board percentage cuts.

Job Growth, 9/90-91	
Nebraska	5.31%
South Dakota	3.06
Utah	3.03
Arkansas	2.78
North Dakota	2.35
Idaho	1.95
Montana	1.91
Arizona	1.50
Colorado	1.44
Hawaii	1.38
Oregon	1.38
New Mexico	1.21
Louisiana	1.20
Wyoming	1.06
Texas	1.05
Kansas	0.82
Mississippi	0.73
Nevada	0.64
West Virginia	0.60
Alaska	0.56
Kentucky	0.51
Illinois	0.43
Minnesota	0.42
Oklahoma	0.40
Iowa	0.31
Washington	0.23
Wisconsin	0.20
Ohio	0.12
South Carolina	-0.07
Indiana	-0.11
North Carolina	-0.65
California	-0.66
United States	**-0.68**
Tennessee	-0.69
Alabama	-0.77
Missouri	-0.78
Pennsylvania	-0.92
Delaware	-1.21
Florida	-1.25
Virginia	-1.38
Maryland	-1.54
Michigan	-1.83
Georgia	-1.89
Vermont	-2.74
New Jersey	-2.84
Connecticut	-2.88
Rhode Island	-3.15
New York	-3.36
Maine	-3.80
New Hampshire	-4.75
Massachusetts	-5.14

Prospects for major tax relief are dim. Less costly relief measures will be considered. Examples are industrial development incentives, business research and development and investment credits, and attempts to lower taxes of low-income wage earners. Some of these could be adopted, but not many. Election-oriented legislators will offer many more costly relief measures -- a penny less sales tax, new sales tax exemptions, new income tax credits -- but these are likely to end their legislative careers in committee.

There will be exceptions. Some states, such as Kansas and Tennessee, may increase taxes enough to fund new initiatives just as Pennsylvania did this year. Litigation on school finance could force action in some states.

States Bucking The Trend?

Will there be exceptions because some state economies are performing well despite recession? Probably not. At the left, states are listed in the order of the percentage gain in jobs from September of 1990 to September of 1991. The top of the page is the logical place to look for states that might buck a national pattern of cutbacks and tax increases. Most of these states have special fiscal problems of one kind or another.

Nebraska (#1) must do something about its property taxes, which have been bouncing around in litigation for several years. An overhaul could require state money to cushion the transition. In South Dakota (#2), the news is that the governor won't press a previously proposed sales tax increase and that income tax proponents aren't likely to be successful. Utah (#3) needs its revenue growth to match growth in education enrollments. Arkansas (#4) just raised taxes for schools, has a revenue shortfall, and has curtailed Medicaid optional services to control cost escalation. Both North Dakota (#5) and Colorado (#9) had special legislative sessions late in 1991. Both deferred discussion of tax hikes until this year.

There are similar stories for states farther down the list. Revenue shortfalls have appeared in Arizona, Montana, Wyoming and many other states in the top half of the list.

THE PERPETUAL FISCAL CRISIS?

> *Forecasts for the future are sobering. Revenue growth will be slow; spending, particularly for health care and prison construction, will continue to explode. Yet, citizens will oppose tax increases. While governors want to expand spending in education, training, and infrastructure investment, their hands will be tied by fiscal reality.*
>
> *The most likely prospect is for a series of tight budgets. Medicaid spending will continue to consume a big share of revenue increases, with federal mandates piled on top of large cost increases resulting from rapid inflation in medical prices as well as greater numbers of senior citizens requiring long-term care. Unless present "get tough" sentencing policies are changed, corrections budgets will also grow rapidly. After paying for increased spending on elementary-secondary schools, state budgets will not have much left over for other programs.*

These glum views of the outlook for state finance reflects what might be called the orthodox perspective on state finances in the 1990s. The statements were published by the major organizations of state officials. The first, by the National Governors' Association in its Governors' Weekly Bulletin (12/13); the second, by the National Association of State Legislatures in a book, The State Fiscal Agenda For The 1990s (1990). Both authors have intimate ties to their publisher. Raymond Scheppach is NGA's executive director and Steven Gold was on NCSL's staff while the book was written.

Summary Of The Theory

The theory is that in the 1990s states will not enjoy as favorable a situation as in the 1980s. Revenue growth will be slower because economic growth won't be as great and because revenue structures won't let states capture the growth that does occur. For example, goods-based sales taxes won't grow as fast as an economy increasingly oriented toward services. Spending growth will be dictated by uncontrollable, or nearly uncontrollable, factors such as school enrollment, corrections, and especially health care. Tax increases won't be an easy solution because voters, subject to the same economic squeeze as states, won't easily surrender additional purchasing power to governments.

State Versions Of The Theory

The same fiscal pessimism has appeared in individual states. The most recent manifestation is California's Growing Taxpayer Squeeze recently released by the governor. Its assessment that there is a mismatch between state spending and revenues is generally accepted by California decisionmakers. From it, the governor concludes that factors that automatically increase spending, such as cost-of-living increases for welfare recipients, must be curbed. Others conclude that taxes must be increased again.

The mismatch is particularly striking in California because of some relatively unique features of both the state's demographics and its tax system. Unlike those of most states, the income tax is indexed for inflation, so there is no fiscal dividend as taxpayers move into higher brackets of the graduated income tax. Because property taxes are constrained by Proposition 13, inflation in property values doesn't translate into automatic increases in local revenue. Spending growth is largely automatic. Proposition 98 guarantees adjustments for inflation and the substantial enrollment growth for both community colleges and public schools. Other laws, some now suspended, guaranteed inflation adjustments for welfare and other entitlements.

A long-term mismatch also appears in California's Commission on State Finance study, 1991 Annual Long-Term General Fund Forecast. Besides identifying a current shortfall, the report projects deficits throughout the 1990s. At the end of the decade, it predicts that spending for current programs will be growing about 8.3% a year while revenues grow at 7.6%.

In other states, projections of spending and revenues show a structural deficit. These can readily be shown in states with fast-growing population and revenue sources that don't respond well to inflation and economic growth. Nevada is a good example. In many Eastern states, there isn't the same demographic pressure on school spending and infrastructure. But there are other problems, such as the demands an aging population creates for Medicaid nursing home payments and needs for infrastructure maintenance.

Implications Of The Theory

The theory has major implications for: (1) tax policy, (2) spending policy and state management, (3) health care, and (4) state approaches to federal policy.

Tax Policy

Part of the problem, as Scheppach puts it, is, "Not only will economic growth be down, but state tax revenues will not keep pace." One solution stressed by Gold is increasing the "elasticity" of state and local tax systems, that is, the responsiveness of tax collections to economic growth. There are several ways to do this. First, eliminating exemptions for the fastest growing portions of a tax base, such as retirement income in the income tax and services in the sales tax. Second, using features that cause revenues to rise faster than income such as a graduated income tax or a flat tax with generous personal exemptions and deductions. Third, basing taxes on value -- like the insurance premiums and public utility taxes -- not physical quantities like gasoline taxes.

Spending Policy And State Management

If needs are expanding more rapidly than revenue and revenue-raising is limited by taxpayer resistance, "more bang for the buck" is the answer. Gold devotes a chapter to increasing accountability, targeting benefits more precisely to those who need them, and what he calls increasing reliance on market mechanisms such as vouchers, decentralization, and privatization. Scheppach talks of more clearly defining priorities, improving effectiveness and efficiency, downsizing, a more entrepreneurial approach to government, more contracting out, quality enhancement, service integration, and more decentralized decisionmaking in return for improved results.

Health Care

Scheppach calls health care reform "the nation's number one domestic priority." He blames uncontrollable health care costs for a significant portion of the fiscal crisis at all levels of government and sees them as limiting the resources that can be put into education, infrastructure, and other public investments. He sees entitlements and mandatory spending, such as many health care programs, as the source of many of the federal government's budget ills and suggests "states are moving toward a similar position." Gold notes that a federal initiative in health care is more likely to add to state costs than reduce them.

Approaches to Federal Policy

One potential solution to a fiscal crisis at the state and local level in the 1990s is to shift some cost to the federal government. Opinions differ on whether it would be appropriate to handle such costs at the federal level. Given other federal commitments but considering reduced needs for defense spending, opinions also differ on whether the federal government could afford to absorb such cost shifts.

The areas of possible federal takeover are unlimited, but several have been stressed by state and local officials in the past: (1) cash welfare including nationally uniform floor levels for those under 65 comparable to those provided for aged and disabled under SSI, (2) indigent medical care, particularly long-term (mostly nursing home) care now provided through Medicaid, and (3) responsibility for special populations such as immigrants. These possibilities aren't pushed by either Gold or Scheppach, but Scheppach sees a different climate in the 1990s for dealing with federal aid cuts and mandates. He describes state finances in the 1980s as "almost too good to be true" and comments:

> *In this growth environment, governors were philosophical about cuts in federal aid to states and other shifts in responsibilities. (During this period, federal aid dropped from 17% to 11% of the states' own tax revenues and the federal government began to tap into state coffers to expand the Medicaid program.)*

> *Voices were raised in opposition. But overall, governors believed the federal deficit was huge and that the states had to accept their share of the budget cuts and take on responsibilities previously met by other levels of government.*
>
> *But the key was that states had the money during the 1980s to accommodate these shifts.*

Implications Of A Perpetual Fiscal Crisis

If there is a perpetual fiscal crisis, there are some significant implications for state policy and for those activities most affected by state funding levels.

One is that multi-year state plans that assume finances will be in better shape in the future aren't appropriate because they can lead to stop and start funding, poor planning, and wasted resources. One example is the multi-year school aid and educational quality plans. Mississippi adopted one, but then didn't fund even the first year. Georgia and other states have consistently decided that their appetite for school spending was higher in passing an education bill with out-year funding than an appropriations bill with budget year funding. Colorado's legislature recently met to scale back a previously adopted school program.

Education isn't the only example. Some states such as Michigan have built prisons but then delayed opening because they didn't have operating money. California and Massachusetts adopted extensive bond-funded programs for many purposes in the 1980s, but now are curtailing them and avoiding new ones. The results of a curtailed large program and of a program designed to be smaller aren't necessarily the same. For example, school construction was squeezed in California by the stop and start process -- getting less than it would have if a smaller lower ceiling for bond issuance had been chosen.

Another implication of perpetual fiscal crisis is that pressures will probably continue for financing a higher percentage of some current costs by fees. In at least two cases, this assumption affects management and spending patterns in major ways. The first is parks, where a higher fee policy will affect what parks are used how much and what types of facilities are most used. In higher education, a continuation of the tuition increases in the past several years will have major effects on enrollment, reducing the need for additional construction in many circumstances and limiting the feasibility of new academic programs because the competition for students will be stiffer.

If there is a perpetual fiscal crisis in state and local government, there will be no room for expensive new initiatives without major tax increases to fund them. This would mean that universal health care plans, major state housing programs, and other proposals for state action would have limited prospects for adoption.

STICKING IT TO THE POOR

> *State budget cuts aimed at the poorest of the poor were so extensive in 1991 and loom so large next year that states seem to be "competing to make themselves unattractive places for the poor to live," a state budget analyst said yesterday.*

This line began the Washington Post's (12/19) description of materials presented by the Center on Budget and Policy Priorities on how recent state budget decisions have impacted the poor. The major conclusion is that the poor were hit hard in many states by decisions on spending -- cash assistance, housing, and other programs -- and by increases in taxes that were often regressive.

Were The Poor Singled Out For Cuts?

The report doesn't take a position on whether, on balance, the poor were hurt more than other groups, indicating data aren't available for such an analysis. It did state that the poor "shouldered a larger share of deficit reduction than other groups in some identifiable respects." One was where regressive taxes, such as a sales tax increase, were used to close budget gaps. The other was that welfare recipients who had benefits cut "are almost certain to have lost a larger share of their income than any other group." This is certainly true except for the small number of persons who lost all their income because they lost their state jobs.

Comparing dollars spent by states in FY 1991 to dollars likely to be spent in FY 1992, the poor most certainly are doing better than other income groups. The big dollar increases in state spending will be in income-tested AFDC and Medicaid because of caseload increases and health care price and utilization increases. Two other gainers in many states, elementary and secondary education and corrections, aren't targeted at the poor, but aren't targeted at other income groups either.

Comparing dollars to be spent in FY 1992 against current service spending levels would be difficult, but would probably show elementary and secondary education doing somewhat better than programs explicitly targeted to the poor. Any method of comparison would show higher education the big loser in the budget decisions of FY 1991 and FY 1992.

The Center's report points out that some states made decisions, like cutting general assistance and AFDC benefit levels and raising sales rather than income taxes, that other states didn't make. From this, it concludes that states didn't need to impact the poor as much as they did. This conclusion is clearly true about programs for the poor, programs for the arts, higher education, or any other single program. In every case, some states will have treated the program of interest more favorably than the average state.

Funding Cash AFDC Benefits

The Center surveyed the states to determine changes in maximum AFDC benefit levels. Only 11 states increased benefits. They were nine states in the West plus Alabama and Florida. Most states left benefits unchanged, and thus with reduced purchasing power. Four states reduced benefits: Michigan by 12.6%, Maryland by 7.1%, Tennessee by 5.1%, and California by 5.1%.

There continue to be striking disparities among the states in the levels of welfare benefits provided under the AFDC program. The maximum benefits, as shown in Table 1, are over $600 a month in five states and over $500 a month in a dozen states. But no family gets over $200 a month in five states or over $300 a month in thirteen states.

Table 1: Maximum Monthly AFDC Payment, January of 1992

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$924	18	Kansas	$422	35	New Mexico	$324
2	Connecticut	680	19	Pennsylvania	421	36	Idaho	317
3	Vermont	673	20	South Dakota	404	37	Florida	303
4	Hawaii	666	21	Utah	402	38	Missouri	292
5	California	663	22	North Dakota	401	39	Indiana	288
6	New York	577	23	Montana	390	40	Georgia	280
7	Rhode Island	554	24	Maryland	377	41	North Carolina	272
8	Massachusetts	539	25	Nevada	372	42	West Virginia	249
9	Minnesota	532	26	Illinois	367	43	Kentucky	228
10	Washington	531	27	Nebraska	364	44	South Carolina	210
11	Wisconsin	517	28	Wyoming	360	45	Arkansas	204
12	New Hampshire	516	29	Colorado	356	46	Louisiana	190
13	Oregon	460	30	Virginia	354	47	Tennessee	185
14	Michigan	459	31	Oklahoma	341	48	Texas	184
15	Maine	453	32	Delaware	338	49	Alabama	149
16	Iowa	426	33	Arizona	334	50	Mississippi	120
17	New Jersey	424	34	Ohio	334			

The interaction of AFDC payment levels with eligibility for AFDC and Medicaid payments is complex. Through it, the Center estimates that some families will be forced out of AFDC and Medicaid eligibility as a result of the changes in Maine, Maryland, Michigan, and Vermont.

More benefit cuts may be in the offing. They are under discussion in Tennessee if no tax package is adopted. Governor Wilson is pushing an initiative for the November 1992 ballot in California that would cut AFDC 10% across the board and make deeper cuts in some circumstances.

Benefit cuts could become an issue in many of the states in the first column of Table 1. Many of them are also states where major fiscal problems are expected in the FY 1993 budget at a time when elected officials aren't amenable to increasing taxes.

Funding Other Benefits

In most states, the cash assistance amounts shown in Table 1 understate the income support provided because of special help called special needs payments and emergency assistance. These deal with extraordinary costs (e.g., burial expenses), adverse circumstances (e.g., eviction, utility cutoff), and other case-by-case needs associated with high utility bills, special clothing needs, and other circumstances. Not all states provide special allowances for such circumstances. Some that do cut back their programs this year. Examples include California, Massachusetts, and Michigan. Some states have had energy assistance programs over and above the federal program. Connecticut and Illinois eliminated their programs in the 1991 budget action while Kansas scaled back its program.

State-funded general assistance programs were eliminated or curtailed in Arizona, Connecticut, Illinois, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Mexico, New York, Ohio, and Washington. The Center calculates that these cuts will affect half a million people, more than a third of all general assistance recipients nationwide. Many of these recipients will simultaneously lose their eligibility for state-funded health benefits outside the Medicaid program.

The federal government assumed responsibility for cash assistance to the aged, blind, and disabled with the Supplemental Security Income (SSI) program adopted in the 1970s. The benefit is uniform nationally. For someone without other income, it will be $422 a month throughout 1992, $633 a month for a couple. When the national benefit standard was adopted, some states opted to supplement the federal payment while other states did not. The pattern since has differed dramatically. A few states have consistently increased their supplements. Others have maintained them at about the original level. In FY 1992, Alaska will supplement the individual benefit by $362 a month, followed by Connecticut ($325), California ($223), and Massachusetts ($129). Supplements between $50 and $100 are provided by Colorado, Idaho, Minnesota, New York, Oklahoma, Rhode Island, Vermont, and Wisconsin.

Supplements for FY 1992 were left unchanged in most states that use them. Reductions were made in Connecticut, Michigan, Utah, and Wisconsin. Alaska adjusted benefits upward for inflation while Colorado and Nebraska adopted increases that in effect rescinded some of the cuts made last year.

State Housing Programs

Housing subsidies have traditionally been provided directly by the federal government and through federal programs administered by local housing authorities, the entities that own and operate public housing units. With a few exceptions, particularly New York, state involvement was minimal except for the use of tax-exempt bond financing by state housing authorities.

Over the past decade, there has been an effort by federal officials and housing advocates to involve state governments more in housing finance. The result has been mixed. In FY 1992, the Center's survey identifies $1,391 million in state housing finance activities, as shown in Table 2. The table doesn't count the self-liquidating mortgage loans financed with tax exempt bonds, but does count housing financed with general obligation bonds.

Table 2: Housing Program Funding In FY 1992 ($ millions)

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New York	$390.7	12	Hawaii	$10.6	23	New Hampshire	$2.4
2	Massachusetts	257.4	13	Illinois	10.1	24	West Virginia	2.0
3	California	241.7	14	Texas	9.0	25	Arizona	1.9
4	Connecticut	112.3	15	Oregon	8.4	26	Rhode Island	1.5
5	New Jersey	90.5	16	Alaska	8.1	27	Delaware	1.3
6	Maryland	52.1	17	Ohio	7.0	28	New Mexico	1.3
7	Pennsylvania	30.9	18	Wisconsin	6.7	29	Utah	1.2
8	Washington	24.0	19	Vermont	6.6	30	Maine	1.0
9	Minnesota	16.8	20	Virginia	5.1	31	Colorado	0.6
10	Michigan	16.0	21	Iowa	4.0	32	Oklahoma	0.4
11	Florida	13.4	22	Georgia	3.4	33	Indiana	0.2

State participation varies substantially. The 17 states not shown have no programs. Another eleven states are spending less than $2.5 million or enough to finance about 50 houses a year. The top five states account for $1.1 billion or over three-fourths of the national total.

State fiscal circumstances are having an impact on these programs. FY 1992 spending for emergency programs for the homeless is down $41 million or 7% and spending for "affordable housing" programs is down $246 million or 22%.

The Outlook For State Programs For The Poor

In the tight budget environment predicted for major states over the next year, no one expects the poor to fare very well. The Center's report urges that state officials shield the poor. It cites Pennsylvania, Texas, and Vermont as states that did this. They made small or no cuts in safety net programs for the poor. Pennsylvania and Vermont accompanied their tax increases with tax cuts for some poor households.

Eight states were singled out as taking the harshest actions in 1991, with Massachusetts and Michigan the prime examples. Not surprisingly, the states with the best treatment of the poor by the Center's reckoning were substantial raisers of taxes, while those with the harshest treatment raised taxes less or not at all. It wouldn't be surprising to see this pattern repeated in 1992. State officials determined not to raise taxes will find cuts in welfare and safety net programs appropriate, while those determined to protect the purchasing power of those programs will find tax increases appropriate.

Steven Gold (Center for the Study of the States) who collaborated on the Center's study testified in December before a subcommittee of the U.S. House Ways and Means Committee on state policies and the poor. He concluded:

> *State cutbacks -- concentrated, as they are, in the states with relatively generous safety nets -- confirm the wisdom of those who call for assumption of welfare costs by the federal government. We could be entering a period in which states increasingly compete to make themselves unattractive places for the poor to reside.*

SPENDING AND TAX LEVELS

New State Comparisons Of Taxes And Spending

The Census Bureau recently published the fiscal information that it alone has the resources to gather -- complete data on roughly 80,000 state and local governments for FY 1990. Again this year, it didn't make the key calculations required for comparisons among states, which **Reports** has done for this article. Also included are calculations of balance in state tax systems that rely on Census data, but are never prepared by the Census Bureau.

Interstate comparisons of state governments alone, or local governments alone, aren't useful for policymaking purposes. The diversity of state-local division of responsibility makes such comparisons meaningless. The State of New Hampshire, which has almost no state school aid, spends much less on schools than the average state, which pays about half of local school costs. New York makes its local governments pay a large part of welfare and Medicaid costs; most states don't. Comparisons of state spending alone are useful as debaters' points in campaigns as states which assume many responsibilities spend much more than states that don't. All comparisons in this article combine state and local spending and taxes.

State And Local Taxes Per Capita

The latest per capita tax comparisons, which will remain current until about this time next year, are shown in Table 3.

Table 3: State And Local General Taxes Per Capita, 1990

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$4,069	17	Vermont	$2,012	34	North Carolina	$1,675
2	New York	3,267	18	Maine	1,974	35	Texas	1,662
3	Connecticut	2,674	19	Oregon	1,934	36	Indiana	1,631
4	Hawaii	2,596	20	Nevada	1,928	37	Utah	1,582
5	New Jersey	2,527	21	Colorado	1,925	38	Oklahoma	1,575
6	Minnesota	2,463	22	Arizona	1,921	39	North Dakota	1,569
7	Massachusetts	2,359	23	Virginia	1,896	40	West Virginia	1,562
8	Maryland	2,305	24	Iowa	1,881	41	South Carolina	1,562
9	California	2,220	25	Pennsylvania	1,859	42	Louisiana	1,562
10	Wyoming	2,209	26	Kansas	1,847	43	Idaho	1,561
11	Washington	2,123	27	Ohio	1,813	44	Missouri	1,552
	United States	**2,016**	28	Nebraska	1,803	45	Kentucky	1,496
12	Illinois	2,102	29	Georgia	1,801	46	South Dakota	1,447
13	Wisconsin	2,090	30	Montana	1,795	47	Tennessee	1,399
14	Michigan	2,068	31	Florida	1,746	48	Alabama	1,328
15	Delaware	2,056	32	New Hampshire	1,693	49	Arkansas	1,273
16	Rhode Island	2,037	33	New Mexico	1,690	50	Mississippi	1,264

The states with the highest per capita incomes tend to have the highest rankings in per capita taxes. Because changes in population and state and local revenues are relatively slow, the rankings tend to be stable from year to year. Among the top ten states, Hawaii moved from fifth to fourth, switching places with New Jersey but reversing the switch the two states made last year. Minnesota moved from eight to sixth knocking Massachusetts and Maryland down a rank. Wisconsin moved from thirteenth to tenth shifting Wyoming out of the top ten. There was no change in the bottom five states.

State And Local Taxes In Relation To Personal Income

Although there are widespread concerns about the rising burden of state and local taxes, the revenues from those taxes as a percentage of personal income has been stable. In FY 1990, they took 11.52% of income, off slightly from the 11.56% taken in FY 1989 and FY 1988. This percentage should move sharply upward for FY 1991 and FY 1992. Recession cuts the growth in personal income. It also affects tax collections but not as much because property taxes are largely unaffected and many state and local governments increased tax rates.

Many users prefer comparisons to personal income to per capita comparisons. The personal income comparisons are shown in Table 4.

Table 4: State And Local Taxes as Percent Of Personal Income, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	19.62%	18	Louisiana	11.64%	34	Oklahoma	10.85%
2	New York	15.54		**United States**	**11.52**	35	Nevada	10.83
3	Wyoming	14.57	19	Nebraska	11.43	36	Massachusetts	10.82
4	Minnesota	14.02	20	California	11.41	37	Kentucky	10.76
5	Hawaii	14.00	21	Rhode Island	11.40	38	Pennsylvania	10.62
6	Wisconsin	12.77	22	South Carolina	11.38	39	New Jersey	10.62
7	New Mexico	12.75	23	Idaho	11.31	40	Texas	10.58
8	Montana	12.64	24	Georgia	11.29	41	Mississippi	10.58
9	Arizona	12.53	25	North Dakota	11.20	42	South Dakota	10.29
10	Washington	12.30	26	Maryland	11.18	43	Indiana	10.25
11	Oregon	12.24	27	North Carolina	11.12	44	Virginia	10.16
12	West Virginia	12.22	28	Kansas	11.04	45	Florida	10.10
13	Utah	12.21	29	Ohio	11.01	46	Arkansas	9.64
14	Maine	12.21	30	Delaware	11.01	47	Alabama	9.56
15	Vermont	12.21	31	Connecticut	11.00	48	Missouri	9.45
16	Michigan	11.88	32	Illinois	10.95	49	Tennessee	9.40
17	Iowa	11.88	33	Colorado	10.89	50	New Hampshire	8.37

Several of the states with high taxes in relation to personal income are getting their revenue from the personal income of residents of other states. Taxes on oil and gas by Alaska (#1), on oil, gas, and coal by Wyoming (#3), and on tourists by Hawaii (#5) are examples. The other states shown with high taxes are simply taxing their resident individuals and businesses much more than other states. By this measure, New York's taxes are 35% higher than the national average and Minnesota's are 22% above average.

The state rankings are little changed from last year. The top three ranks are unchanged while Minnesota took fourth from Hawaii, dropping it to fifth. In the bottom six ranks, the only change was that Tennessee gave 48th to Missouri and took its former rank of 49th. There are more changes in the middle ranks, primarily reflecting movement in personal income (the denominator) rather than taxes (the numerator). New England's rapid growth was continuing through CY 1989, the year of the personal income data Census uses for this comparison. As a result, Maine moved from fifth two years ago to sixth last year to 14th this year. Massachusetts moved from 22nd to 28th to 36th. These states will soar in rankings next year and in the year following because they have raised taxes while their personal income growth has trailed the rest of the nation.

Property Tax Burdens

Table 5 expresses property taxes as a percentage of personal income. The U. S. average of 3.58% is slightly up from the 3.52% in FY 1989.

Table 5: State And Local Property Taxes As A Percent Of Personal Income, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	6.01%	18	Texas	4.14%	34	Pennsylvania	2.95%
2	Wyoming	5.98	19	Minnesota	4.03	35	South Carolina	2.92
3	Montana	5.83	20	Kansas	3.93	36	Maryland	2.86
4	New Hampshire	5.70	21	Illinois	3.93	37	Mississippi	2.85
5	Oregon	5.40	22	Colorado	3.87	38	Nevada	2.38
6	Vermont	5.01		**United States**	**3.58**	39	North Carolina	2.34
7	New York	4.87	23	Massachusetts	3.56	40	Tennessee	2.16
8	New Jersey	4.86	24	Florida	3.54	41	Missouri	2.08
9	Nebraska	4.76	25	North Dakota	3.41	42	Hawaii	2.07
10	Michigan	4.71	26	Washington	3.38	43	West Virginia	2.01
11	Wisconsin	4.51	27	Utah	3.33	44	Louisiana	2.00
12	Rhode Island	4.51	28	Virginia	3.20	45	Oklahoma	1.91
13	Maine	4.46	29	Ohio	3.13	46	Kentucky	1.82
14	Connecticut	4.34	30	California	3.11	47	Arkansas	1.73
15	Iowa	4.17	31	Georgia	3.10	48	New Mexico	1.65
16	South Dakota	4.15	32	Idaho	3.01	49	Delaware	1.62
17	Arizona	4.15	33	Indiana	2.97	50	Alabama	1.17

The top three states owe their position primarily to taxing resource wealth, not individuals and commercial activities. The other top states have high property taxes because they don't use other taxes (e.g., sales and income in New Hampshire, sales in Oregon) or have generally high taxes and spending like New York and Vermont.

The level of burden in these states is high enough to have considerable impact on state policy. Since the year covered by these data: (1) New Hampshire has come closer than ever to enacting an income tax, (2) Oregon voters approved an initiative to roll back property taxes and force the state to replace the lost revenue, (3) Vermont legislators opted for a major tax increase this year rather than following other New England states in cutting local aid sharply, (4) Nebraska and New Jersey raised income and sales taxes to lower property taxes, (5) Michigan set new limits on property taxes after a ballot measure to raise sales taxes to lower property taxes was rejected by voters, and (6) Wisconsin counties have been adopting a new local option sales tax.

Sales Tax Burdens

Sales tax collections of state and local government are shown in Table 6. A broad definition of sales taxes was used to develop the table. It includes regular sales and use taxes plus special excise taxes on commodities such as tobacco and services such as public utilities.

Table 6: State And Local Sales Taxes As Percent Of Personal Income, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Washington	7.66%	18	Arkansas	4.51%	34	Nebraska	3.77%
2	Hawaii	7.57	19	North Dakota	4.43	35	Kansas	3.76
3	Nevada	6.96	20	Connecticut	4.35	36	Rhode Island	3.60
4	New Mexico	6.75	21	New York	4.15	37	Ohio	3.55
5	Louisiana	5.94	22	Missouri	4.11	38	Iowa	3.46
6	Tennessee	5.71	23	North Carolina	4.11	39	Vermont	3.46
7	Arizona	5.51		**United States**	**4.08**	40	Pennsylvania	3.18
8	Florida	5.33	24	Idaho	4.06	41	Virginia	3.10
9	West Virginia	5.30	25	Illinois	4.06	42	New Jersey	2.96
10	Texas	5.27	26	Kentucky	4.02	43	Maryland	2.92
11	Mississippi	5.20	27	Minnesota	3.97	44	Michigan	2.76
12	Utah	4.96	28	Colorado	3.90	45	Massachusetts	2.21
13	South Dakota	4.93	29	Maine	3.89	46	Montana	1.61
14	Alabama	4.82	30	Indiana	3.85	47	Alaska	1.56
15	Oklahoma	4.66	31	Wyoming	3.83	48	Delaware	1.29
16	Georgia	4.56	32	California	3.82	49	New Hampshire	1.21
17	South Carolina	4.53	33	Wisconsin	3.80	50	Oregon	1.09

With their ability to collect sales taxes from the personal income of other states by taxing tourists, Hawaii and Nevada rank high in this measure. So do states that have no income tax like Washington, Nevada, Tennessee, and Florida. The five states at the bottom of the list have no general sales tax.

The aggregate sales tax burden of 4.08% of personal income is little changed from 4.10% the prior year. By moving its burden from 7.37% of income to 7.66%, Washington took the top spot held last year by Hawaii. Also by tax increases, West Virginia moved from 18th last year to ninth. Over the next several years, there will be major reshuffling of ranks in the middle of this table because some states have increased sales tax rates and some haven't. Local option taxes should raise the burdens in South Carolina, Wisconsin, and a few other states. State increases will raise the burdens in New Jersey, Pennsylvania, and other states. Connecticut should drop because some of its new income tax revenue is being used to lower the sales tax.

Individual Income Tax Burdens

The use of personal income taxes continues to show wide differences in state tax policy that are reflected in Table 7.

Table 7: State And Local Personal Income Taxes As Percent Of Personal Income, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	New York	4.72%	18	Georgia	2.78%	34	Illinois	1.95%
2	Maryland	4.30	19	Vermont	2.70	35	Arizona	1.89
3	Oregon	4.07	20	Virginia	2.67	36	New Mexico	1.80
4	Delaware	3.86	21	Michigan	2.67	37	New Jersey	1.60
5	Massachusetts	3.74	22	Indiana	2.65	38	Mississippi	1.40
6	Minnesota	3.74	23	Montana	2.47	39	Louisiana	1.30
7	North Carolina	3.39	24	Pennsylvania	2.46	40	North Dakota	1.18
8	Hawaii	3.38		**United States**	**2.43**	41	Connecticut	0.76
9	Ohio	3.32	25	Arkansas	2.38	42	New Hampshire	0.18
10	Wisconsin	3.28	26	Rhode Island	2.38	43	Tennessee	0.14
11	Kentucky	3.03	27	Missouri	2.38		South Dakota	0.00
12	Maine	2.92	28	Colorado	2.31		Texas	0.00
13	California	2.90	29	West Virginia	2.25		Alaska	0.00
14	Idaho	2.90	30	Oklahoma	2.19		Florida	0.00
15	Utah	2.90	31	Alabama	2.09		Nevada	0.00
16	Iowa	2.90	32	Kansas	2.07		Washington	0.00
17	South Carolina	2.88	33	Nebraska	1.99		Wyoming	0.00

Seven states have nothing resembling a personal income tax. In FY 1990, three others -- Connecticut, New Hampshire, and Tennessee -- reached only a limited portion of income such as interest, dividends, and capital gains. While these ten states tap less than 1% of personal income, eleven states tax more than 3% of all personal income.

From FY 1989 to FY 1990 there were few changes in this table. The national average burden moved marginally up from 2.41% to 2.43%. The top ranks remained unchanged except that Hawaii reduced its taxes and dropped from fourth to eighth, moving other states up a rank.

Bigger changes will appear in future years. Connecticut's new income tax and tax increases in Arizona, Illinois, and New Jersey should move those states out of the bottom third. Increases in Pennsylvania, Rhode Island, Oklahoma, and Nebraska will move those states up as well.

BALANCE IN STATE TAX SYSTEMS

Some experts on state tax systems urge state officials to keep their systems "balanced." The concept is roughly equal reliance on each of the "big three" taxes -- property, sales, and income. Table 8 provides a basis for assessing how well states have been doing this. It shows revenues raised by each of the big three as a percentage of the total revenues raised by all three.

Table 8: Percentage Of State And Local Tax Revenue Of Major Tax Revenues Raised From Each Of The Major Taxes, 1990

State	Property	Sales	Income	State	Property	Sales	Income
Alabama	15%	60%	26%	Nebraska	45%	36%	19%
Alaska	79	21	0	Nevada	25	75	0
Arizona	36	48	16	New Hampshire	80	17	3
Arkansas	20	52	28	New Jersey	52	31	17
California	32	39	30	New Mexico	16	66	18
Colorado	38	39	23	New York	35	30	34
Connecticut	46	46	8	North Carolina	24	42	34
Delaware	24	19	57	North Dakota	38	49	13
Florida	40	60	0	Ohio	31	35	33
Georgia	30	44	27	Oklahoma	22	53	25
Hawaii	16	58	26	Oregon	51	10	39
Idaho	30	41	29	Pennsylvania	34	37	29
Illinois	40	41	20	Rhode Island	43	34	23
Indiana	31	41	28	South Carolina	28	44	28
Iowa	40	33	28	South Dakota	45	55	0
Kansas	40	39	21	Tennessee	27	71	2
Kentucky	20	45	34	Texas	44	56	0
Louisiana	22	64	14	Utah	30	44	26
Maine	40	34	26	Vermont	45	31	24
Maryland	28	29	43	Virginia	36	35	30
Massachusetts	37	23	39	Washington	31	69	0
Michigan	46	27	26	West Virginia	21	55	24
Minnesota	34	34	32	Wisconsin	39	33	28
Mississippi	30	55	15	Wyoming	61	39	0
Missouri	24	48	28	**United States**	**35**	**40**	**24**
Montana	59	16	25				

Except in special circumstances, such as Alaska's reliance on taxing oil and gas, there is considerable pressure for states with unbalanced tax systems to change them. Those interested in more spending urge use of the unused or underused tax, as happened with the income tax in Connecticut this year. Those affected by overused taxes, such as property taxpayers in Oregon, also urge change -- not necessarily advocating higher other taxes but advocating reduction in the tax that concerns them.

As a result, major deviations from balance often identify the states where the pressures for tax changes will be greatest. Table 9 shows the states with the highest percentage reliance on individual tax sources (as shown in Table 8). It designates those states where major change has already taken place (*) and where change is now being considered seriously (**).

Table 9: States With High And Low Reliance On Particular Tax Sources, FY 1990

Rank	Property	Sales	Income
1	New Hampshire**	Nevada*	Delaware
2	Alaska	Tennessee**	Maryland**
3	Wyoming	Washington**	Massachusetts**
4	Montana**	New Mexico**	Oregon*
5	New Jersey*	Louisiana**	North Carolina*
6	Oregon*	Florida**	New York
7	Michigan**	Alabama**	Kentucky
8	Connecticut*	Hawaii	Ohio
9	Nebraska*	Texas	Minnesota
10	South Dakota**	West Virginia	Virginia

The table suggests that the agitation for movement toward a more balanced tax system is substantial. The environment for change has been strongest in the high property tax states. There is much less pressure for change in the states with high reliance on individual income taxes, partly because income taxes account for more than 40% of big three tax yield in only the top two states. Sales taxes are over 50% of big three yield in 14 states and property taxes over 40% of big three yield in 13 states.

MISCELLANY

Health Care Reform

The more specific I get ... the more I run the risk of having this whole thing fall apart.

With that comment, Vermont's Governor Dean summed up the problems of state elected officials in dealing with health care. Dean, a doctor, is trying to cope with recommendations of the Governor's Blue Ribbon Commission on Health Care. The commission agreed on goals, such as cost containment and universal access to health services, but little else except creating a state agency to carry on its work. Given the state's fiscal circumstances, the major options being considered for 1992 are those involving regulation of health insurers and providers, not those involving paying for care.

Interacting State And Local Fiscal Problems

As recession continues it becomes harder and harder for local governments and the states to adopt the roles of drowning man and lifeguard. The states can't provide fiscal bailouts if their own finances are in trouble. Nor can they shift their own fiscal problems downward if a significant number of local governments will be in serious trouble as a result. The apt analogy may not be potential drowning victim and rescuer, but two potential drowning victims.

In assessing the situation ("Too Many Needs, Too Little Money," State Legislatures, December), NCSL's fiscal affairs director Ronald Snell notes the recession "has brought a reversal of the decade-long pattern of increasing state aid to local governments." He observes that state aid is different from federal aid, with primary emphasis on education and highways rather than aid for general purposes and infrastructure. Noting that some states, particularly in the Northeast, have recently reduced aid to local government, Snell concludes, "The challenge now is for state and local officials to understand how hard economic times injure all kinds of governments and to find new ways to balance public desires for services against limited public resources."

New York State and New York City have recently been dancing to the same tune, though not exactly as partners. After considerable agony, both adopted balanced FY 1992 budgets with noticeable cuts in current service spending and tax increases. Recently officials of both have announced that their FY 1993 current service budgets are out of balance and that shortfalls are also likely in the current fiscal year. Then within a month of the first announcement, both announced that the problems could be more serious than indicated in the previous announcement.

The gap numbers are large, something like $3-4 billion for the state and upwards of $1.2 billion for the city. The city's problem would be minimized by more state aid. The state's problem would be minimized by less state aid. Similar problems will be found throughout the nation, but are most serious in the Northeast.

Unfunded mandates are a major part of local officials' concerns with how states cause fiscal problems for local government, though defining them and quantifying their impact isn't easy, as NCSL staffer Scott Mackey details in "When Local Business Becomes State Business," (State Legislatures, December).

Urbanization of America

The Census Bureau recently announced that 75.2% of the nation's population is now (1990) urban, up from 73.7% in 1980. The urbanization statistics for each state are shown in Table 10.

Table 10: Percentage Of State Population That Is Urban, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	California	92.6%	17	Ohio	74.1%	34	Georgia	63.2%
2	New Jersey	89.4	18	Delaware	73.0	35	Tennessee	60.9
3	Hawaii	89.0	19	New Mexico	73.0	36	Iowa	60.6
4	Nevada	88.3	20	Michigan	70.5	37	Alabama	60.4
5	Arizona	87.5	21	Oregon	70.5	38	Idaho	57.4
6	Utah	87.0	22	Minnesota	69.9	39	South Carolina	54.6
7	Rhode Island	86.0	23	Virginia	69.6	40	Arkansas	53.5
8	Florida	84.8	24	Kansas	69.1	41	North Dakota	53.3
9	Illinois	84.6	25	Pennsylvania	68.9	42	Montana	52.5
10	Massachusetts	84.3	26	Missouri	68.7	43	Kentucky	51.8
11	New York	84.3	27	Louisiana	68.1	44	New Hampshire	51.0
12	Colorado	82.4	28	Oklahoma	67.7	45	North Carolina	50.4
13	Maryland	81.3	29	Alaska	67.5	46	South Dakota	50.0
14	Texas	80.3	30	Nebraska	66.1	47	Mississippi	47.1
15	Connecticut	79.1	31	Wisconsin	65.7	48	Maine	44.6
16	Washington	76.4	32	Wyoming	65.0	49	West Virginia	36.1
	United States	**75.2**	33	Indiana	64.9	50	Vermont	32.2

The urban-rural comparison was undoubtedly a more meaningful one before widespread ownership of automobiles. The Census Bureau definition includes persons living in densely populated areas and places of 2,500 more outside urbanized areas. The definition won't necessarily fit with common notions of urban, such as a housing development in an unincorporated area near a central city. The definition can lead to some unexpected results. While the nation became more urban from 1980 to 1990, eleven states became more rural including Michigan, Pennsylvania, and Rhode Island.

College Savings Programs

In the late 1980s, Michigan offered parents and others the opportunity to guarantee payment of tuition costs at state universities by contracts made with the state when the children were young. The concept was that the state would hold the money in the Michigan Education Trust, which would be self supporting because the (assumed) rate of return on investments would be enough higher than the increase in tuition costs to cover the administrative expenses.

The plan was presumed to be preferable to individual parents making the same investments because: (1) the parents would be tempted to spend the money on something else, (2) the state would better be able to purchase a diversified portfolio of investments with low administrative costs, (3) the parents would be protected from lower-than-expected interest rates and higher-than-expected tuition increases, and (4) the interest earnings in the trust wouldn't be taxable while interest would be taxable if the parents held the money. The program has been popular with 55,000 contracts in effect with an average investment of about $8,000. Several states copied the idea.

Many states didn't follow Michigan's lead. Some did nothing. Some issued some of their regular tax-exempt debt issues in small denominations and touted them as appropriate investments for parents seeking to accumulate a nest egg for college costs.

Michigan has now discontinued its program. In part it is a casualty of changing economic circumstances. It was originally assumed that the state could earn nearly 10% on investments and that tuition would rise 7.3% annually, leaving 2.5% spread for administrative costs and reserves. Partly because of restrictions on state appropriations, university tuition has been rising faster than assumed. In the current economic circumstances, interest rates are lower, dropping the expected spread to under 1%. In addition, IRS is pressing its case that the interest earned must be taxable -- to Michigan's fund if not to the parent-taxpayer.

TECHNICAL NOTES

Another Tight Year: NCSL has surveyed legislative fiscal officers to produce NCSL State Budget Update: November 1991 and updated the survey in December. For details on shortfalls, see those documents and State Budget & Tax News coverage of individual states.

Sticking It To The Poor: The report, The States And The Poor: How Budget Decisions In 1991 Affected Low Income People, was published by the Center on Budget and Policy Priorities (777 N. Capitol St., N.E., Washington, DC 20002).

Spending And Tax Levels: The data on spending and taxes come from the Census Bureau's Government Finances: 1989-90, Preliminary Report. The personal income and population data are those used in the Census report, State Government Finances: 1990. The data are for fiscal years ending in 1990, FY 1990 for states and many local governments and CY 1990 for the local governments on a calendar year basis. Following Census practice, personal income is for CY 1990 and the population count is from the 1990 Census.

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S P R

VOLUME 10 ISSUE 2

IN THIS ISSUE

Different states face different challenges because of differing demograhics -- how fast population is growing or shrinking, the impact of immigration, whether states are drawing residents from other states, and births of future public school and university students. Developments since the 1990 Census may foretell trends of a decade.

- Population Growth And Change p. 2

As recession continues, over half the states find tax collections running below estimates and at least 35 states have spending running above estimates. Cutting spending is the preferred solution, but there are two lists predicting a substantial number of tax hikes this year. The public's preference is higher spending and lower taxes.

- The Fiscal Outlook p. 9

State officials are looking at ways they can combat recession. Federal leaders are preparing economic stimulus packages, some with new grants for state and local government. Meanwhile, state and local officials are struggling to balance their budgets, which some economists argue has perverse economic effects.

- States And The Recession p. 14

Other articles cover a range of topics including the costs of health care in state budgets, how states compare in birth rates and taxes on affluent families, a lull in use of voter initiatives, whether high payments draw welfare recipients, and two aspects of population statistics.

- Health Costs Beyond Medicaid p. 19
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STATE POLICY REPORTS

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January 1992 (Second Of Two January Issues)

POPULATION GROWTH AND CHANGE

New Population Statistics

The Census Bureau has released new population estimates. They show the U. S. population (including 598,000 District of Columbia residents) to be 252,177,000 as of July 1, 1991. The state estimates shown in Table 1 are consistent with the 1990 Census. This means they *exclude* five million or so residents arguably missed by the Census count.

Table 1: State Population (000) In 1991
With Cumulative Percentage Of 50-State Total

Rank	State	Number	Cum. Pct.	Rank	State	Number	Cum. Pct.
1	California	30,380	12.1%	26	Colorado	3,377	85.1%
2	New York	18,058	19.3	27	Connecticut	3,291	86.4
3	Texas	17,349	26.1	28	Oklahoma	3,175	87.6
4	Florida	13,277	31.4	29	Oregon	2,922	88.8
5	Pennsylvania	11,961	36.2	30	Iowa	2,795	89.9
6	Illinois	11,543	40.8	31	Mississippi	2,592	90.9
7	Ohio	10,939	45.1	32	Kansas	2,495	91.9
8	Michigan	9,368	48.8	33	Arkansas	2,372	92.9
9	New Jersey	7,760	51.9	34	West Virginia	1,801	93.6
10	North Carolina	6,737	54.6	35	Utah	1,770	94.3
11	Georgia	6,623	57.2	36	Nebraska	1,593	94.9
12	Virginia	6,286	59.7	37	New Mexico	1,548	95.5
13	Massachusetts	5,996	62.1	38	Nevada	1,284	96.0
14	Indiana	5,610	64.3	39	Maine	1,235	96.5
15	Missouri	5,158	66.4	40	Hawaii	1,135	97.0
16	Washington	5,018	68.4	41	New Hampshire	1,105	97.4
17	Wisconsin	4,955	70.4	42	Idaho	1,039	97.8
18	Tennessee	4,953	72.3	43	Rhode Island	1,004	98.2
19	Maryland	4,860	74.3	44	Montana	808	98.6
20	Minnesota	4,432	76.0	45	South Dakota	703	98.8
21	Louisiana	4,252	77.7	46	Delaware	680	99.1
22	Alabama	4,089	79.3	47	North Dakota	635	99.4
23	Arizona	3,750	80.8	48	Alaska	570	99.6
24	Kentucky	3,713	82.3	49	Vermont	567	99.8
25	South Carolina	3,560	83.7	50	Wyoming	460	100.0

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The cumulative percentage column provides an easy way to see population concentration -- a reminder that generalization about numbers of states aren't always equivalent to conclusions about the number of people affected. In the extreme case, half the states could adopt a particular policy or experience a particular problem and only impact 15% of the population. Nine states have 52% of the population while 20 states have 76%.

Population Growth

American population grew by 1.4% between the April 1990 Census and the July 1991 estimate. This 15 month measurement, which moves the estimating date to the July date used by the Census Bureau between Census years, is equivalent to an annual rate of change of 1.11%. That growth is slightly above the annual rates reported in the 1980s. The 15-month changes for the states are shown in Table 2.

Table 2: Population Growth Percentage, April 1990 to July 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	6.82%	18	North Carolina	1.63%	34	Michigan	0.79%
2	Alaska	3.64	19	Virginia	1.60	35	Kentucky	0.76
3	Idaho	3.18	20	Tennessee	1.56	36	Louisiana	0.76
4	Washington	3.10		**United States**	**1.39**	37	Mississippi	0.74
5	Oregon	2.81	21	Wyoming	1.32	38	Vermont	0.71
6	Utah	2.73	22	Minnesota	1.30	39	Kansas	0.69
7	Florida	2.62	23	Wisconsin	1.29	40	Pennsylvania	0.66
8	Colorado	2.52	24	Indiana	1.19	41	Iowa	0.65
9	Hawaii	2.44	25	Alabama	1.19	42	Maine	0.57
10	Arizona	2.32	26	Montana	1.13	43	West Virginia	0.45
11	Georgia	2.24	27	South Dakota	1.01	44	New Jersey	0.39
12	New Mexico	2.18	28	Illinois	0.98	45	New York	0.38
13	Texas	2.13	29	Nebraska	0.95	46	Connecticut	0.12
14	Delaware	2.10	30	Oklahoma	0.92	47	Rhode Island	0.10
15	South Carolina	2.09	31	Arkansas	0.89	48	Massachusetts	-0.33
16	California	2.08	32	Ohio	0.85	49	New Hampshire	-0.36
17	Maryland	1.65	33	Missouri	0.80	50	North Dakota	-0.63

The estimates show substantial disparities among the states. Nevada has been growing at a rate that would double its population roughly every 15 years. Four Northwestern states -- Alaska, Idaho, Oregon, and Washington -- are growing at twice the national average rate. Meanwhile, North Dakota and two New England states lost population.

State rankings in population growth closely resemble those in the Index of State Economic Momentum (Issue 24) and economic indicators such as employment, housing starts, and personal income. People tend to move toward economic opportunities and away from recessionary conditions.

This is vividly indicated by contrasting annual rates of growth of four states. In the first half of the 1980s, when the Midwest was suffering from recession, Illinois grew hardly at all (0.04% annual rate) while Colorado, Oklahoma, and New Hampshire were growing at 1.5% or better. In the late 1980s, when the Western states suffered from resource gluts, particularly in oil, Oklahoma lost 0.8% of its population every year and Colorado growth dropped to 0.55% while Illinois continued with no change, and New Hampshire boomed (2.25%) along with the rest of New England. From 1990 to 1991, Colorado grew at a 2% rate, Illinois and Oklahoma were just off the national pace with growth of about 0.75%, and New Hampshire lost a third of a percent of its population.

Sources Of Population Change

Population Change, 1990-1991
Rates Per 10,000 People

Source		Number
Natural Increase		81
Births	166	
Deaths	85	
Migration		30
From Abroad	30	
Within U.S. net	0	
Total		111

Population change is a result of two separate factors. The first is the *natural increase*, which is the additions to population from births and the subtractions from deaths. The second is *net migration*, which is the number of in-migrants minus the number of out-migrants. Table 3, at the left, shows the annual rates of change from the latest population estimates.

Without migration, U.S. population would grow annually by 81 people for every 10,000 people, or a growth rate of 0.81%. Migration from abroad adds 30 more people. Migration within the U.S. is a zero sum game for the nation, but not for individual states.

Natural Population Growth

Most states come close to having the national average increase in population of 0.8% a year from the surplus of births over deaths. As a result, without major migration, they could expect a gradual increase in demand for population-driven public services like transportation, education, and law enforcement.

Some of the states differ significantly from national patterns. The differences have major implications for state policies. States with high rates of natural population growth, like California and Hawaii, tend to worry extensively about such issues as quality of life and the environment, congestion, and regulation of growth. They need to spend more for infrastructure such as schools and roads.

Table 4 shows the leading and lagging ten states in birth rates, death rates, and the resulting natural increase in population. The first column shows the highest and lowest states in natural increases. Absent any new migration, Alaska's population would grow at 1.7% a year and Utah's at 1.56%. West Virginia, at 0.15%, would need a decade to show as much growth as these states would have in a year.

Table 4: Top And Bottom States In Natural Increase Factors
Number Per 10,000 Population, 1990-1991

Rank	Natural Increase		Births		Deaths	
1	Alaska	173	Alaska	211	West Virginia	106
2	Utah	156	Utah	208	Arkansas	104
3	California	132	California	204	Florida	102
4	Hawaii	122	Arizona	186	Pennsylvania	101
5	Texas	111	Texas	184	Missouri	98
6	New Mexico	110	Hawaii	182	Mississippi	97
7	Arizona	109	New Mexico	179	Alabama	97
8	Nevada	99	Nevada	172	Rhode Island	97
9	Colorado	96	Georgia	172	Oklahoma	96
10	Georgia	93	Louisiana	170	Iowa	96
	United States	**81**	**United States**	**166**	**United States**	**85**
41	North Dakota	56	Wisconsin	148	Texas	73
42	Oklahoma	55	Vermont	147	Nevada	73
43	Kentucky	52	Rhode Island	147	California	72
44	Maine	52	Kentucky	146	Idaho	72
45	Arkansas	50	North Dakota	145	New Mexico	69
46	Rhode Island	50	Montana	144	Wyoming	69
47	Florida	49	Pennsylvania	144	Colorado	64
48	Iowa	45	Maine	141	Hawaii	60
49	Pennsylvania	43	Iowa	141	Utah	52
50	West Virginia	15	West Virginia	121	Alaska	38

Because natural increase is births minus deaths, the way to have a high increase is to have a high birth rate and a low death rate. The second column shows the birth rates. They differ considerably although fertility rates (shown elsewhere in this issue) exhibit little difference. The percentage of the population that is women of childbearing age is more significant than how often those women have children.

The third column shows death rates. In the top four states, one out of every 100 residents will die before a year passes. In Utah, only about one in 200 will die in a year.

One key links the three columns: the age of the population. Western states have a younger population and thus a population more likely to have children and less likely to die.

The Impact of Migration

For the nation as whole, migration is less important to population growth than natural increases. This is not true for the individual states. The most rapid growth from 1990 to 1991 by natural increase was 1.7% in Alaska while the most rapid growth from migration was 4.3% in Nevada. The slowest natural growth was +0.15% in West Virginia, but 14 states lost population due to migration. The migration changes are shown in Table 5.

Table 5: Net Population Change From Migration, 1990-1991
Number Per 10,000 Population, 1990-1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Nevada	429	18	Virginia	46	34	Iowa	8
2	Idaho	166	19	Wisconsin	42	35	Missouri	7
3	Oregon	159	20	Maryland	41	36	Ohio	5
4	Washington	159	21	Alabama	36	37	Illinois	-3
5	Florida	158	22	Montana	34	38	Maine	-8
6	Alaska	118	23	California	33	39	Vermont	-11
7	Colorado	101		**United States**	**30**	40	Kansas	-13
8	Delaware	84	24	Indiana	29	41	Michigan	-14
9	Georgia	83	25	Minnesota	28	42	Mississippi	-14
10	South Carolina	83	26	Arkansas	22	43	Louisiana	-23
11	Arizona	73	27	Wyoming	21	44	New Jersey	-38
12	Hawaii	66	28	Oklahoma	19	45	New York	-43
13	Tennessee	64	29	West Virginia	19	46	Rhode Island	-44
14	Utah	62	30	South Dakota	16	47	Connecticut	-59
15	New Mexico	61	31	Nebraska	11	48	Massachusetts	-95
16	North Carolina	59	32	Pennsylvania	11	49	North Dakota	-109
17	Texas	57	33	Kentucky	9	50	New Hampshire	-118

The migration shown is "net." That is, migration of one person out of a state and one person into a state would have no effect on the numbers as the movement would have no impact on population change in either state.

Seven states gained population at an annual rate of more than 1%. All are Western states except Florida. Fourteen states lost population due to net migration. The movement exceeded 1% of population only in North Dakota, reflecting a pattern of decades, and New Hampshire, reflecting depressed economic conditions in New England.

Is it desirable for a state to be at the top of Table 5? Not everyone would answer the same way. Answering the question, and thus evaluating state performance, depends on where the in-migrants come from, why they came, and why out-migrants left. Assessing this is aided by the breakdowns of migration patterns in Tables 6 and 7.

Migration From Abroad

Table 6 deals only with migration from abroad. The net inflow, which adds 0.3% to population each year, is about the same as total immigration from abroad. There is almost no migration out of the United States.

Table 6: Net Population Change From Migration From Other Countries
Number Per 10,000 Population, 1990-1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Hawaii	87	17	Virginia	20	34	Georgia	8
2	California	83	18	Arizona	19	35	Indiana	8
3	New York	66	19	Utah	17	36	Missouri	8
4	Illinois	40	20	Alaska	16	37	North Dakota	7
5	New Jersey	40	21	Michigan	15	38	Montana	6
	United States	**30**	22	Oklahoma	15	39	New Hampshire	6
6	Texas	35	23	Kansas	14	40	North Carolina	6
7	Florida	32	24	Louisiana	14	41	South Carolina	6
8	Connecticut	25	25	Minnesota	14	42	Tennessee	6
9	Massachusetts	25	26	Idaho	12	43	Vermont	6
10	Washington	25	27	Pennsylvania	12	44	Alabama	5
11	Nevada	24	28	Delaware	11	45	Arkansas	5
12	Rhode Island	24	29	Iowa	10	46	Kentucky	5
13	Maryland	23	30	Wyoming	10	47	Maine	5
14	Colorado	20	31	Nebraska	9	48	Mississippi	5
15	New Mexico	20	32	Ohio	9	49	West Virginia	5
16	Oregon	20	33	Wisconsin	9	50	South Dakota	4

Table 6 is striking for the concentration of immigration. Forty-five states were below the national average. Thirty-seven states were two-thirds of the national average or less. Twenty states had less than 0.1% annual population growth from immigration, less than one third of the national average.

Immigration to California and New York and, to a lesser degree, the Chicago area and Northern New Jersey creates substantial demands on social services. Officials of these states see this immigration as creating major fiscal problems both at the state level and in communities like Chicago, Los Angeles, and New York. About the only thing on which California legislative leaders and the governor agreed upon in their late 1991 budget negotiations was that immigration burdens were one cause of the budget gap. They decided to press for federal policy changes so that more of the costs of services for migrants (e.g., welfare, Medicaid, schools) would be covered by the federal government. New York State and City officials have long held the same view. Table 6 suggests the problem they face. What they see as a major problem doesn't have much effect in most states.

Migration Within The United States

The rapid movement of people within the country shown by Table 7 is a tribute to how rapidly the American economy adjusts to change. It is also an indication of challenges faced by the states most affected.

In a single year, six states grew by more than 1% just from migration from other states. Nevada grew an astounding 4%. In the same year, four states saw more than 1% of their population pick up and leave.

Table 7: Net Population Change From Migration Within The United States
Number Per 10,000 Population, 1990-1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Nevada	405	18	Montana	28	34	Ohio	-4
2	Idaho	154	19	Virginia	26	35	Maine	-13
3	Oregon	139	20	Texas	22	36	Vermont	-17
4	Washington	134	21	Indiana	21	37	Mississippi	-19
5	Florida	126	22	Maryland	18	38	Hawaii	-21
6	Alaska	102	23	Arkansas	17	39	Kansas	-27
7	Colorado	81	24	Minnesota	14	40	Michigan	-29
8	South Carolina	77	25	West Virginia	14	41	Louisiana	-37
9	Georgia	75	26	South Dakota	12	42	Illinois	-43
10	Delaware	73	27	Wyoming	11	43	California	-50
11	Tennessee	58	28	Kentucky	4	44	Rhode Island	-68
12	Arizona	54	29	Oklahoma	4	45	New Jersey	-78
13	North Carolina	53	30	Nebraska	2	46	Connecticut	-84
14	Utah	45		**United States**	0	47	New York	-109
15	New Mexico	41	31	Missouri	-1	48	North Dakota	-116
16	Wisconsin	33	32	Pennsylvania	-1	49	Massachusetts	-120
17	Alabama	31	33	Iowa	-2	50	New Hampshire	-124

Substantial out-migration is a bad sign for a state from an economic development perspective. It means that people are voting with their feet -- working age people in search of better jobs and retirees in search of a better environment. Some of the movement is dramatic and publicized, such as California families seeking original California values by moving to Oregon and retirees from the Northeast moving to Florida and Nevada. But most migration isn't dramatic pulling up of stakes. Instead, it occurs when people leave for college, a temporary job, or military service and simply don't come back.

Substantial net in-migration is a sign that a state is doing something right. In economic development terms, it means that job or retirement opportunities are drawing new residents while few current residents are leaving.

THE FISCAL OUTLOOK

Introduction

With no sign that the economy has hit bottom, state finances continue to deteriorate. Most budgets for this year (FY 1992) are in worse shape than when enacted. Balances to begin the year and tax collections have both been below predictions. Spending -- particularly for Medicaid, AFDC, and corrections -- is above estimates in at least 35 states.

Because of structural deficits (Issue 1), the situation for some states would be grim even if economic growth were normal. Continued recession means slow revenue growth and continued recession-related spending. This year's solutions become next year's problems -- low balances, depleted rainy day funds, overdue bills, debt to pay back, and one-time devices that must be replaced with real revenues or spending cuts the next year.

Shortfalls And Their Cures

A recent NCSL survey found FY 1992 tax collections falling below estimates in 26 states. This understates the total by the number of states which were holding the bad news for release with the governor's budget in January. The list, at the left, shows 16 states with a revenue deficiency of 3% or more. For states with a fiscal year ending in June, that would mean making up double that, or 6%, by spending cuts that became effective in January. The situation is even worse in New York, where the fiscal year ends in March.

Some states with large shortfalls -- Maryland, Maine, Florida, and Georgia -- brought legislatures into session late in 1991 to adopt spending cuts. They went beyond employment freezes and one-time measures to include mid-year reductions in school aid, local government aid, and funds for higher education. Other states --California, Connecticut, and New York -- failed to act despite recommendations from the governor. In some states -- Illinois and Ohio -- the governor didn't recommend action before January. A few states are handling shortfalls without major cutbacks. Indiana came into the fiscal year better cushioned for downturns than most states. New Hampshire is one of the states taking advantage of Medicaid bootstrap financing now that its legitimacy is established. Its late 1991 legislative action is providing the salvation for the FY 1992 and probably the FY 1993 fiscal situation.

Table 8: Revenue Shortfall

1	Maryland	8.5%
1	Montana	8.5
3	N. Hampshire	8.4
4	Maine	6.7
5	Florida	5.6
6	Georgia	5.1
7	Rhode Island	4.4
8	Arkansas	4.3
9	California	4.1
9	S. Carolina	4.1
11	Washington	4.0
12	Virginia	3.7
13	Minnesota	3.5
14	Connecticut	3.4
14	Kentucky	3.4
16	Arizona	3.0
16	Nevada	3.0
18	Ohio	2.9
19	Michigan	2.3
20	Illinois	2.0
20	Tennessee	2.0
22	New York	1.7
23	New Jersey	1.6
24	Mississippi	0.7
25	New Mexico	0.6
26	Indiana	0.5

Possible Tax Increases

Money magazine's January issue guesses which states will raise taxes this year by giving each state grades: 21 "A" grades for no major change, 6 "B" for moderate chance of increase, 12 "C" for strong probability of increase, and 11 "D" for tax increases as a "sure bet." Table 9 shows the states classified as having some probability of enacting major tax increases in 1992.

Table 9: States Assessed By Money As Possibly Raising Taxes In 1992

Increase "Sure Bet"	Strong Probability	Moderate Chance
Florida*	Tennessee*	Texas
New Hampshire	North Dakota	Wisconsin
Illinois*	Mississippi*	New Mexico
Indiana	Alabama*	West Virginia
Kansas*	South Carolina	Arizona
Colorado*	Michigan*	California
Georgia	Montana*	
Ohio*	Virginia	
Rhode Island	Nebraska	
Maryland	Massachusetts	
New York*	Oregon	
	Louisiana	

Reports is aware of only one other published speculation on which of the 50 states will raise taxes, the **TaxWatch** list which appeared in State Budget & Tax News in its November 11, 1991 issue. An asterisk (*) in the table above indicates the states on that list.

The number of states on either the SB&TN or the Money list exceeds by a wide margin the number of states where governors and/or legislative leaders have indicated a tax increase is needed. This gap can be expected to narrow as time passes.

For example, when New York officials started talking about a shortfall last fall, legislative leaders and the governor agreed that a tax increase isn't the answer, that the answer lies in cutting spending. That was the easy part. Then they started discussing which spending to cut, how, and when. That proved to be the hard part. With no agreement through ten months of the fiscal year, Moody's reduced the state's already low bond rating. Standard and Poor's suggested a reduced rating was possible. While New York may not raise taxes, that alternative is more attractive in January than it was in October.

Doing What The Public Wants

> *It is not unusual for the public to want it both ways. They do not have to make the decision. But no matter what happens, it is likely to be unpopular and not be very well received.*

This quote could be from anyone looking at the choice between raising state taxes and cutting spending. It is from the managing editor of the California Poll, reporting on a November survey for the Sacramento Bee (12/20).

Those surveyed were given 16 categories of spending and asked if they would favor cuts. Cuts in 15 categories drew less than 25% support. In the 16th category 38% favored cuts but 44% favored spending about the same level. That category, regulation of business and the professions, involves minor outlays compared with the other categories. More than half the state's citizens want higher spending for mental health, the elderly and disabled, health care for the poor, law enforcement, public schools (highest with 65%), AIDS research, and aid to the homeless.

Three-fourths believe the level of state and local taxes is too high -- 38% say "much too high" and 38% say "somewhat high." Perception that taxes are too high is up from 59% in February. The increase probably results from tax hikes in the interim and the widespread publicity surrounding the legislative discussion of those increases before their enactment.

The clear and continuing preference of voters in California and elsewhere is that states increase spending and reduce taxes.

The Higher Education Perspective

> *As bad as the financial picture has been for higher education in this academic year, 1992-93 could be even worse.*

This was the Chronicle Of Higher Education's summary of its 50-state survey of higher education officials which appeared in its January 8 issue. Despite a grim outlook, higher education officials haven't been reluctant to ask for money. In over half the states, their budget requests call for increases above 10%. The second sentence of the magazine's summary concluded for higher education what **Reports** has concluded for all education, social services, health, and other state activities.

> *With many state legislatures beginning their 1992 legislative sessions this month, the recession and continuing budget rises in the states are expected to preoccupy lawmakers and overwhelm all the other issues affecting higher education.*

Will Fiscal Issues Be Tougher This Year? The Impact of Deferrals

FY 1993
The chickens come home
to roost

This graphic was part of the presentation the Rhode Island budget office made to executive and legislative leaders late last year. The detailed presentation explained the sources of the structural budget deficit and the compounding of that problem by the recession. On top of both structural and cyclical problems, in the new budget year (FY 1993), Rhode Island officials will have to deal with whatever problems they created by prior year actions. Rhode Island used "deferrals" in prior years that account for nearly 10% of the budget. The chickens coming home to roost include delays in school aid payments, rescheduling of debt service, deferral of certain employee compensation, and missing some scheduled employer contributions to retirement plans.

In California, the legislative fiscal office (Legislative Analyst) described a similar situation and warned that the FY 1993 budget would need "additional ongoing solutions," a polite way to describe permanent tax increases and spending cuts.

> *In acting on the 1991-92 budget, the Legislature made many very difficult decisions. Many of these decisions were targeted at resolving the structural portion of the budget problem. However, the expectation of an imminent economic recovery led the Legislature to also rely on short-term strategies to maintain programs until economic growth caused revenues to catch up. The failure of the recovery to materialize undermined these strategies, and leads us to the conclusion that the 1992-93 budget will require additional ongoing solutions.*

Not all states relied on deferrals to FY 1993 to solve their FY 1991 and FY 1992 budget problems, but many did. Not all of them will have to face the music in FY 1993, but many will.

Will Fiscal Issues Be Tougher This Year? Patience Wearing Thin

> *As I said last year and the year before that, this will only hurt for a little while although our projections suggest the situation won't improve.*

While the quote above is fabricated, it is how the fiscal message must sound to educators, health care providers, and others who have been affected by measures to deal with temporary adversity in state finances.

Clashing Claims: Every year there are issues pitting claimants for the states' resources against other claimants, indirectly against the taxpayer, and directly against the guardians of the resources like governors, legislative leaders, appropriations committees, and executive and legislative budget staffs. This year's major claims aren't new: (1) school aid and teacher salaries, (2) state employee compensation, (3) aid to local government, (4) reimbursement rates for health care providers, (5) welfare cash payments, (6) support of higher education, and (7) support of other state functions from the arts and corrections to zoos. Because, in this tight budget year, many claimants will get much less than they want, clashes will likely be sharp.

Clashes could be even sharper than the fiscal situation alone might suggest. The reason is that the outcomes will seem less temporary. It is one thing for a group like employees or nursing homes to accept less for one year when: (1) there are external causes like recession which are easily understood, (2) other groups seem to be suffering about equally, and (3) state officials can creditably make the case that the sacrifice is temporary and the group's long term aspirations will be supported in the long run. This story has led to widespread acquiescence in budget cuts in some circumstances. Although there were lively local controversies, from a national perspective this was the situation last year in California, Florida, Virginia, and some other states.

Permanent Temporary Problems: The "temporary" story wears thin when the temporary situation continues for a long time. This is increasingly the case in New England, as indicated by the ferocity of the battle over employee compensation measures in the Massachusetts legislature in November and December. It is also the case in states that have held the line on taxes for some years despite strong demographic pressures for increases, as typified by education budgets in Mississippi and Alabama.

The "temporary" story also wears thin where state officials talk simultaneously about structural budget deficits and a determination not to raise taxes. Examples are California and New York. Finally, some of the more raucous money disputes this year are likely in states that have escaped many of the effects of recession. There state officials can't easily blame economic necessity for what some groups see as parsimony. Look for major disputes, probably including teacher strikes, in Utah and Washington.

The spending-oriented groups often recognize that they aren't likely to achieve their objectives in a zero-sum competition with each other. So they coalesce to varying degrees around the concept of raising taxes. This worked in Missouri, which now faces choices more difficult than those of most states. Last year legislators and the governor agreed on a tax increase package that, under the state constitution, required voter approval. Voters rejected the package by a 2-1 margin in November. Now there are three bad choices: (1) try again with the voters, (2) adopt a smaller tax increase not requiring voter approval but risking voter wrath, or (3) live with existing resources.

STATES AND THE RECESSION

Introduction

Congress is now considering a variety of economic stimulus packages including tax cuts (see Issue 24 for impacts on states), aid to business, and new or expanded aid to state and local government. Federal grants of unrestricted cash and/or funds for public works were a common element of recession-fighting strategies in the 1960s and 1970s. These programs weren't repeated in the early 1980s recessions, in part because the earlier programs had clearly had their major spending impacts well after the recessions had ended.

Stimulating The Economy -- The Gang That Couldn't Shoot Straight

Many state and local officials have counseled that altering matching requirements in grant programs would be a simple and fast way to use state and local government to inject added spending into the economy and/or to prevent tax increases that would otherwise take place. The Congress reflected this approach (and concerns about the ability and willingness of state and local officials to provide matching money) in two small grant programs last year -- drug control and the new housing (HOME) program.

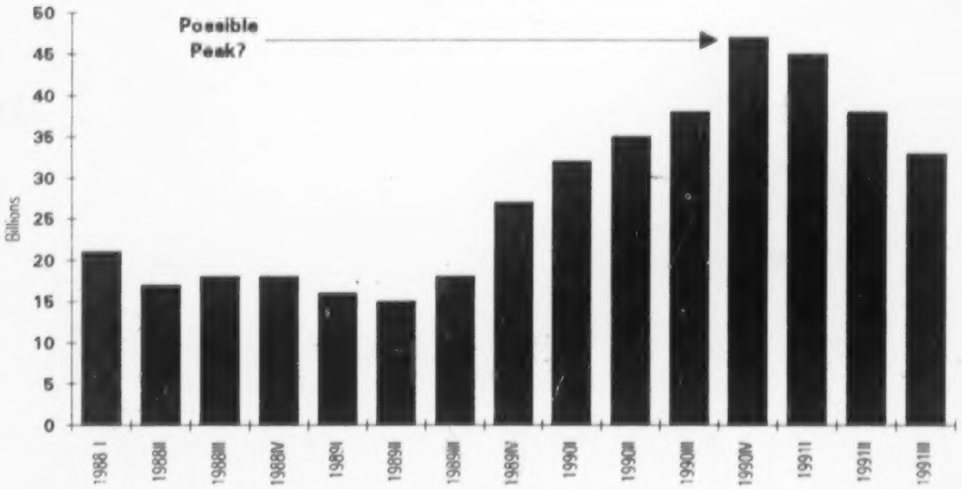
The surface transportation bill was the major Congressional action affecting matching. It permits states to spend without match and pay their match later, in effect borrowing their match. The bill was highly touted by the President and Congressional leaders as a job-creating bill. The first problem was that the legislation passed after the old law had expired, adding delay to the already existing uncertainty about what the new rules would be. The second problem was that the new law, in the words of Federal Funds Information for States, "inadvertently reduced the 1992 federal-aid highway obligation ceiling by $1.2 billion."

How, one might ask, can Congress -- with a budget of over a billion dollars for the sole purpose of making good policy decisions -- possibly *inadvertently* knock $1.2 billion out of highway and transit spending while trying to make a record of accelerating public works? The answer is, not surprisingly, complex. Part of the problem comes from a decision to convert an old post office in Brooklyn into a courthouse in 1994. Under the budget control legislation, this decision works its way back into FY 1992. In FY 1992, it affects the highway obligation limit. Those involved in the Congress will seek corrective legislation early this year, but FFIS expects that legislation to correct only $1 billion of the $1.2 billion error and notes "even passage of this legislation will delay the availability of highway obligational authority to the states."

Stimulating The Economy, Perverse State and Local Officials?

The Joint Economic Committee has already started hearings on policies to deal with recession. Witnesses are suggesting ways for government to add to purchasing power by taxing less or spending more, increasing deficits in the process. This is the traditional Keynesian prescription for recession fighting. State and local officials march to the beat of a different drum: requirements for balanced budgets. By constitutions, statutes, and campaign promises, they are encouraged not to overspend their revenues. As a result, their economy-stimulating deficits in recession are the accidental results of underestimating spending and overestimating revenues. The result is deficit spending. It shows clearly in the chart below as rapid growth in state and local deficits in 1990.

State And Local Deficits By Quarter



The chart, drawn from Commerce Department data, shows that decisions in 80,000 state and local governments are having their expected impact. Taxes are being raised and spending is being cut to restore balanced budgets. Deficits are trending downward, which is the wrong result from the perspective of those looking for economic stimulus.

The state and local deficit won't drop below a $15-25 billion annual rate primarily because of continuing bond-financed capital outlays. Inflation and a growing population mean these governments are constantly borrowing more than they repay. Using debt-financed capital is the major way state officials can simultaneously act to stimulate their economies and comply with their balanced budget requirements.

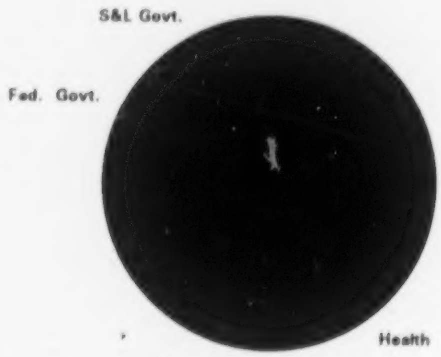
Look for a boom in these proposals this year, already signaled by their prominence in the state-of-the-state messages of the governors of California, New Jersey, and New York. Debt-financed capital outlays will grow for another reason. States in the South and West that have traditionally relied on pay-as-you-go financing are increasingly turning to borrowing, which relieves pressures on their regular budgets. For example, pay-as-you-go capital was sharply curtailed in Virginia's budget cutbacks in 1990 and 1991. Now the governor proposes financing higher education projects by borrowing.

Where Jobs Are Lost And Gained

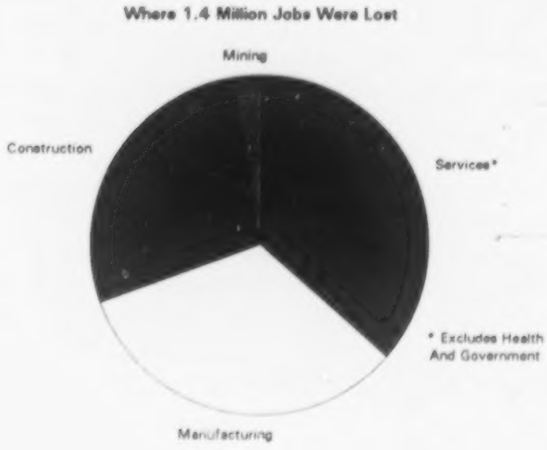
While by no means immune from the impacts of economic downturn, governments tend to be a stabilizing force in recession. This pattern is appearing in the current recession. While the economy lost 888,000 jobs between November of 1990 and November of 1991, government employment grew by 97,000 jobs. This 0.5% increase wasn't large enough to match population growth of about 1%, but tended to offset some of the much larger loss of jobs in the private sector.

The small gain in government employment was part of a larger gain in service jobs, but these failed to offset even larger losses in goods-producing jobs. Overall in the year ending in November, there were gains of about 500,000 jobs in some industries and losses of 1.4 million in others.

Where 500,000 Jobs Were Gained



As shown in the chart, the bulk of the 500,000 job gain was in health care. The 403,000 new health jobs represented an increase of 5% in a single year. Government accounted for the rest of the gain. With revenues most adversely affected by business conditions, states cut employment about 21,000. Local employment increased 97,000. The state decrease was 0.5% while the local increase was about the same percentage and the federal increase was 0.8%.



The profile of the 1.4 million jobs lost, shown at the left, reflects the concentration of losses in the goods-producing sectors of the economy. In a single year, 5.3% of mining jobs disappeared. So did 7.6% of the nation's construction jobs and 2.4% of manufacturing jobs. Within manufacturing, losses were 3.7% in making durable goods like cars and appliances and only 0.7% in making non-durable goods such as food products and apparel.

For those who worry about the competitiveness of the U.S. economy, these statistics are likely to be alarming. Most of the job losses occurred in sectors that produce outputs that can compete with other nation's. All the job gains occurred in activities that are essentially consumptive, producing nothing to be traded with other nations or to raise future national output.

This distinction can be taken too far. Some services, such as health care, are sold to foreign nationals. There is no reason to call a municipal electric worker in Los Angeles non-productive because he works for government while calling one in Boston productive because he works for a private electric company. Also, some spending on health care and education arguably contributes to production. But most of the expansion in state and local employment was probably related to corrections and social work. Most of the expansion in health care probably was associated with caring for persons who will not be working -- those over 65, the disabled, and the terminally ill.

Tax Policy

There isn't much on-the-record discussion of tax policy so far this year. Tax cuts of any significance are pretty much out of the question. As described in Issue 1, the states with the best economic performance have special demands limiting resources available for tax relief, while other states don't have the resources to consider the possibility.

Tax increases are still being treated as an unthinkable option in most states. Particularly in states with legislative elections this year, tax hikes are currently the off-the-record, under-the-table option for governors and legislative leaders.

But in many states, the leading tax options are clearly defined. In Minnesota and Wisconsin, they are options previously passed by the legislature and vetoed by the governor. In Missouri, they are a scaled down version of the package rejected by voters in November. In Kansas, they are a scaled down version of the sales tax increases proposed last year by the governor but not passed. In the Dakotas, they are the sales tax increases that have been considered and rejected over the past several years. In Massachusetts, the leading tax option is the sales tax increase long backed by education groups. In Illinois, it is the flat rate income tax increase that is beginning to be discussed.

Leading Tax Options

If raising taxes were like playing musical chairs, what options would lawmakers select when the music stopped? Probably about the same kind of mixture that was adopted in 1991. It would include selections from a long list: (1) rate increases in the sales tax and more broadening of the base, (2) income tax rate increases in the higher brackets, perhaps with relief for low income taxpayers, and across-the-board rate increases, (3) increases in selective excise taxes such as alcohol and tobacco taxes, (4) increases in corporate income and franchise taxes, particularly when personal taxes are being increased, and (5) the major changes in health provider taxes necessary to come into line with federal rules on Medicaid bootstrap financing.

Increasing local taxes should again be popular, particularly in ways where state officials don't leave their footprints on local increases. Raising the local effort requirement in school aid programs will achieve this result, provide more money for education, and help satisfy those complaining and litigating over inequity in school finance. Offering additional local option taxes and broadening the purposes for which existing authority can be used should also prove popular.

Increasing state taxes to relieve local property taxes is always a popular concept. The topic is particularly hot in states under pressure from voters to reduce property taxes. In Idaho, where a ballot measure to limit taxes is under discussion, the governor has held a tax summit. In his state-of-the-state message, he endorsed trying to find a way to limit local property taxes. In Oregon, where a property tax limit measure has already passed and income taxes are high, most state leaders in and out of government quietly agree on the solution. But that solution, adopting a sales tax, has been rejected by voters every time it has been proposed.

In states not under pressure of voter initiatives, there will probably be considerable caution about raising state taxes to lower property taxes. If nothing else, the fate of New Jersey legislators backing such a measure may cause legislators in other states to wait until after the 1992 elections to make any such move.

Taxing Business

Three states -- Florida, New Hampshire, and maybe Louisiana -- offer the greatest possibilities for innovations in business tax policy. All three states need money to maintain current services, though current thinking in New Hampshire is that Medicaid bootstrap financing adopted in a special session late last year may have solved most of the immediate problem. Officials of all three states have constraints against a major broad-based tax. Florida can't have a personal income tax without a voter-approved constitutional amendment that polls indicate voters won't support. Louisiana's property tax is constrained by a massive homestead exemption. Many New Hampshire officials, including the governor, have "taken the pledge" against adopting either a sales or personal income tax.

There are major constraints on raising the corporate income tax in all three states. Many Louisiana officials and business leaders are convinced that the state already relies too heavily on business taxes. Florida, and particularly New Hampshire, find that much economic activity gets organized in non-taxable proprietorships and partnerships rather than corporations. The profits tax rate is already high in all three relative to competitor states.

Governor Chiles vaguely describes a Florida solution as a "broad-based business tax." Consulting reports turn this concept into a value added tax similar to Michigan's. Past reform studies in Louisiana have also focused on the value added concept. New Hampshire has seen many proposals defining business activity plus a family of proposals that provide a corporate tax equivalent for income of proprietorships and partnerships.

Nevada faced problems similar to those of these three states, but acted in 1991 to cure them with what closely resembles a "head tax," a tax on the number of employees. The combination of dissatisfaction with this type of tax and a state budget that needs added revenue could cause business tax issues to be revisited.

HEALTH COSTS BEYOND MEDICAID

Don't look for any dramatic changes or roll call votes on massive revisions of health care financing this year. But do look for the subject to affect policymaking indirectly in spending, tax, and even in regulatory activity. These pervasive effects aren't always explicitly identified, but this doesn't make them less important, just less well understood.

How pervasive are the effects? Sometime, probably last year, the nation's health care bill passed the state and local tax bill in size. Put another way, Americans are paying more for health than for all state and local activities put together.

While Medicaid cost increases get most of the attention, rising health costs in other areas of state budgets are part of the continuing cost pressures causing tight budgets, spending cutbacks, and tax increases.

Employee Health Care: Health care for state employees is one major category. Generally states pay all or nearly all health insurance costs for employees and retired employees. Many states pay most or all the costs of coverage for their dependents. Higher prices and increased use of services have tended to produce double-digit increases in cost per person covered by employee health insurance just as they have for Medicaid. Attempts to control these costs have proven equally ineffective. Most states have refrained from shifting the costs to employees, respecting a willingness of employee organizations to live with lower (taxable) salary increases to keep higher (non-taxable) benefits.

A few states have tried to handle fiscal problems by delaying payment of health bills for employees, as well as delaying payment of Medicaid bills. West Virginia did this in the late 1980s to the point that some doctors wouldn't serve state employees unless the employees themselves made the payment. That situation was reached with some physicians in Illinois last spring and apparently will arise again this spring. The shortfall in employee health insurance is about $100 million, part the delayed payment of bills carried over from last year and part unanticipated cost increases.

Health Care For Retirees: Many states cover the health care costs of retirees and, often, their dependents. For employees that have reached age 65, Medicare covers most, but not all, of the costs. For the many employees retiring before age 65, annual costs can run $5,000 per person. This liability has become large relative to the cash pension. As a result, those who control accounting practices have argued that they should be forward funded during the employees' working years, just as the cash pension is. Without any exceptions known to **Reports**, states aren't doing this. To comply with private accounting standards, more and more large companies are recognizing an actuarially determined amount each year as an expense and setting funds aside to pay health costs after retirement.

Among the private companies, coverage of retiree health costs is common among state-regulated companies that provide electric service, water supply, natural gas distribution, and local telephone service. The effect of current funding of these future health costs is to increase the operating costs of these utilities and, other things being equal, increase the rates states let them charge customers. Rate increases for this purpose have already been granted in Connecticut, Florida, North Carolina, and probably other states. But, at least temporarily, regulators in Georgia and Hawaii have rejected the increase requests. Cases are pending in most of the larger states. The increases involved are in the broad 1-5% range.

COMPARING STATE AND LOCAL TAX BURDENS

For the past several years, Money has compared state tax burdens using sales, income, and gasoline taxes. This predictably skewed the comparisons by showing light burdens in states with high local property taxes. In its January issue, the magazine has remedied that deficiency with some dramatic changes. For example, New Hampshire dropped from having the second lowest tax burden to the tenth. The new rankings are shown in Table 10.

Table 10: State And Local Taxes On Money Household, 1991

Rank	State	Tax Bill	Rank	State	Tax Bill	Rank	State	Tax Bill
1	New York	$8,841	18	Michigan	$6,635	35	Alabama	$5,343
2	Oregon	8,168	19	California	6,610	36	New Mexico	5,332
3	Maryland	7,986	20	New Jersey	6,597	37	Mississippi	5,185
4	Massachusetts	7,830	21	North Carolina	6,507	38	Missouri	5,185
5	Wisconsin	7,762	22	South Carolina	6,480	39	Delaware	4,753
6	Rhode Island	7,716	23	Georgia	6,417	40	North Dakota	4,530
7	Maine	7,673	24	Colorado	6,269	41	New Hampshire	4,299
8	Minnesota	7,145	25	Connecticut	6,201	42	Louisiana	4,254
9	Utah	7,121	26	Kansas	6,144	43	Washington	3,845
10	Nebraska	7,052	27	Indiana	6,084	44	Texas	3,625
11	Iowa	7,016	28	Arizona	5,892	45	South Dakota	3,470
12	Virginia	6,868	29	Kentucky	5,871	46	Tennessee	3,354
13	Idaho	6,863	30	Illinois	5,830	47	Florida	3,185
14	Ohio	6,849	31	Oklahoma	5,684	48	Wyoming	2,717
15	Montana	6,700	32	Pennsylvania	5,676	49	Nevada	2,588
16	Hawaii	6,693	33	Arkansas	5,585	50	Alaska	2,013
17	Vermont	6,643	34	West Virginia	5,374			

The typical household used for comparisons was definitely a higher income household, one the magazine says is typical of its subscribers. Adjusted gross income in a four person household is nearly $75,000. The high income used for comparison and the exclusion of hidden taxes (e.g., franchise, corporate income, gross receipts) mean that the comparisons have limitations. However, using relatively high incomes and ignoring hidden taxes are probably appropriate for people that might consider moving for tax purposes.

The magazine quotes a Gallup Poll indicating 6% of Money subscribers interviewed had moved to another state to save on taxes, up from 3% who said they had moved for this purpose in 1989 and 1990 polls. Some 22% said they had considered changing states to save on taxes. This isn't representative of the national population, however, as Money subscribers are disproportionately retired or nearing retirement age, have more money than most, and, as indicated by their subscription, worry about finances more.

FERTILITY AND BIRTH RATES

The birth rates relevant for calculating changes in population relate population created by birth to the population that already resides in a state, regardless of age. While this is the right concept for explaining population growth as is done in the lead article in this issue, it says nothing about the propensity to bear children. Clearly a state like Florida with lots of persons over 65 will, other things being equal, have fewer births per resident than Western states with a younger population.

The fertility rate, shown in Table 11, focuses on those who have babies -- females between ages 15 and 44. In any given year, 0.7% of these women, or 692 out of 10,000, have a child.

Table 11: Births Per 10,000 Females Aged 15-44, 1969

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Utah	898	17	Kansas	681	34	Montana	638
2	Alaska	897	17	Maryland	681	34	North Dakota	638
3	Arizona	834	19	New Jersey	674	34	Wisconsin	638
4	California	822	19	South Carolina	674	37	Massachusetts	635
5	New Mexico	764	21	Arkansas	669	38	Oklahoma	633
6	Texas	753	22	Michigan	668	39	Colorado	631
7	Nevada	743	23	Delaware	662	40	Indiana	630
8	Hawaii	742	24	Nebraska	660	41	Rhode Island	628
9	Florida	723	25	Connecticut	659	42	Tennessee	623
10	Mississippi	706	25	Minnesota	659	43	Pennsylvania	617
10	South Dakota	706	27	Missouri	657	44	Oregon	610
12	Georgia	700	28	New Hampshire	655	45	Maine	609
13	Illinois	692	28	Washington	655	46	Iowa	608
13	Louisiana	692	30	North Carolina	650	47	Kentucky	605
	United States	**692**	31	Virginia	645	48	Vermont	598
15	New York	690	32	Ohio	644	49	Wyoming	585
16	Idaho	682	33	Alabama	642	50	West Virginia	515

The differences among states are relatively slight. While West Virginia is 26% below the national average, no other state is more than 15% below it. Only five states are 10% or more above the national average. Small differences among states in the middle of the table are probably meaningless. Small errors in the estimate of female population can produce significant swings in the reported fertility rate. In general, Blacks, Hispanics, and members of the Church of Jesus Christ of The Later Day Saints (Mormons) have higher birth rates than other population groups.

INITIATIVE AND REFERENDUM

The deadline for putting voter initiated measures on the June California ballot passed with no measures qualified by the nearly 400,000 signatures needed. There were 13 measures on the November ballot. Initiated legislation and constitutional amendments have been a major force in shaping California policy and have had significant impacts in other states. Examples: Proposition 13 property tax limits, Proposition 98 guaranteeing education funding, Proposition 103 on insurance regulation, and Proposition 104 on legislative terms and staffing. There was considerable speculation that California's initiative process would prove nationally significant on other issues, such as health insurance.

Theories of what happened abound. Perhaps those interested in California politics are preoccupied with reapportionment. Perhaps those who finance campaigns are short of money because of recession. Another highly plausible theory is that potential sponsors and funders of initiative campaigns are afraid they can't win because of the tendency voters exhibited in the November election -- voting NO on every initiative.

MIGRATION OF WELFARE RECIPIENTS

In some states there is concern that welfare benefits well above those of other states are drawing welfare recipients. Such movement, if significant, would raise state costs for schools and welfare and increase concentrations of low income residents without any obvious benefits. The solution, being pushed particularly in California and Wisconsin, is capping benefits for new residents so they wouldn't gain by migration. Critics argue that there is no significant movement of recipients to higher benefit states.

Data has been scarce. Wisconsin's social service secretary offers some in an OpEd piece in the Milwaukee Journal (12/29). In a recent three month period, the state acquired information on residency of new AFDC recipients. Statewide, 12% had been in the state less than 90 days and never lived in Wisconsin before. In Milwaukee, the figure was 20%. An AFDC family of three gets $517 there, but only $367 in nearby Chicago. The Thompson Administration will again push for a four county demonstration program. For six months, new AFDC families would get only the benefit level of the state from which they came. The proposal lost by a narrow margin in the legislature last year.

Must a state treat all its residents equally? Under the "right to travel" in the U.S. Constitution and bills of rights in state constitutions, a case can be made that past residency can't be used in determining benefits. This was the conclusion when Alaska tried to pick long-time residents for special benefits paid from its oil money. But merely setting foot in a state and declaring an intent to stay isn't enough to get equal rights to every state service. If it were, there would be no one paying non-resident tuition at state universities.

STATISTICS ON RACE

Information involving race appears infrequently in state legislative debates and in Reports. One reason is that racial distinctions aren't generally relevant to the decisions to be made. For example, the concerns about persons migrating to get higher welfare benefits have been over persons of: (1) Race A when Washington worried about the problem in its general assistance program in the late 1980s, (2) Race B in Wisconsin (discussed above), and (3) Races B and C in California. Knowing which is which race isn't seen as aiding policymaking in situations like these, at least by most policymakers. The resulting policy will be color/race blind for legal reasons, if not policy reasons.

Another problem is that statistics based on race/ethnicity are seriously flawed conceptually and operationally.

Conceptually, there isn't symmetry in treatment of ethnic groups. Remember the WASP (White-Anglo-Saxon Protestant) that people used to rail against as having power and privilege? WASP was defined exclusively. So a child of a WASP and a non-WASP wasn't a WASP. Black was defined inclusively, so if either parent was black, the child was defined as black. The child's child was also black. As a result, no one talks about WASPs anymore because WASPs have intermarried with Catholics, Germanic groups, Asians, and blacks. In 1989, some federal definitions were changed. For example, a black child results from the union of a black mother and a white father, but reversing the races of the parents produces a white child.

All these definitional fine points are lost on citizens. This is important because in a national Census, a survey, or on intake forms in schools, social service programs and hospitals the practical definition of race/ethnicity is whatever box someone checks on a form. The results are assessed in three articles in the Journal Of The American Medical Association (1/8). Conclusion: "individuals may be assigned a different race at birth, during the course of life, and at death." One practical implication explored by the articles is that infant mortality statistics by race are flawed because some children are counted as black in the birth count but counted as white if they die within the first year of life.

POPULATION ESTIMATES IN POLITICS

Expect controversy over population estimates to continue for the next several years as representatives of states and cities most affected by possible undercounts seek to have their estimates increased. Getting an estimate increased can affect political power as measured by representation in legislatures, the Congress, and the electoral college that selects the President. Population also enters into the federal limits on certain tax-exempt bonds. In some programs, the amount of federal assistance is a function of population, so higher estimates would bring more federal money.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 3

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Fiscal problems will dominate the legislative sessions, but there is much more on the agenda. Many legislatures will defer action on both highly controversial issues and on high cost proposais in health care, education, and other fields. Other issues, such as redistricting and financing Medicaid, can't be avoided.

- Hot Issues of 1992 p. 4

The latest surveys confirm the seriousness of state fiscal problems and the strong determination to avoid tax increases as a solution.

- Fiscal Update p. 14

In tight budgets, welfare spending clashes with other priorities leading to a tougher outlook on welfare. New welfare reform plans are appearing in many states.

- The Assault On Welfare Dependency p. 16

Few states will get through the 1992 sessions without facing revisions of school finance. Texas legislators are tiring of writing formulas for court approval. New Jersey just approved a plan which cuts benefits for some recipients and raises them for others.

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- Despite a tough fiscal environment, reducing taxes is a topic in several states.

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February 1992 (First Of Two February Issues)

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THE STATE OF THE STATES

Introduction

In January, most governors addressed their legislatures on the state of the state. The governors use this message as a forum for their report on how things are going, an opportunity to repeat the central themes of their administration, and a chance to outline their legislative program for the coming session. Some also use it as a place for their budget recommendations. In these broad terms, the state-of-the-state messages this year weren't much different from those of other years.

Many governors, probably looking back at what they said last year, lauded the success of Operation Desert Storm and commented on changes in the world following the breakup of the Soviet Union. Comments on the overall condition of the nation's economy, international economic competition, and hardships associated with the recession were common.

Some legislative leaders deliver substantive messages at the beginning of sessions or deliver formal responses to the governors' messages. Leaders' responses to a survey on priorities were compiled by the National Conference Of State Legislatures (NCSL) in its 14-page Leaders' Outlook 1992: Top Priorities For State Legislatures.

Federal Issues

The governors engaged in a substantial amount of bashing of federal action and inaction on such subjects as management of the nation's economy, non-responsiveness to human needs, regulation, and mandates. Governor Cuomo quoted former New York Governor Franklin Roosevelt who said in his state-of-the-state message 60 years ago, "In any state of this union of states, the complete solving of those economic problems which are national in scope is an impossibility without leadership and a plan of action by our national government."

The NCSL survey suggested:

> *In a word, they [legislative leaders] are angry. With broad consensus, they condemned federal policymakers for causing or compounding state fiscal distress with unfunded mandates in general, and expanded Medicaid obligations in particular; by aid cuts to local government; by failure to deal responsibly with the federal deficit; and by failure to lead the country out of economic recession.*

While there was criticism of federal policy, the state-of-the-state message emphasis was not on looking for federal solutions. Instead, governors stressed what states could do in the context of the economy and federal policy.

Challenge In Adversity

The governors talked about the economy, its impact on people and on state budgets. The situation was often described as challenging. Governor Wilson said, "We must transform this season of crisis into the greatest season of reform in California history." Governor Cuomo said, "We must build a New York with our own hands, without waiting for Washington." Governor Castle's comment is that an economic downturn "isn't all bad. It's good for government to contract. It tightens up efficiency." Governor Bayh organized his entire message around the challenge theme, starting this way:

> *My friends, we meet at a time of tremendous challenge for our state. We face:*
>
> > *the challenge of providing quality education to our children so they may prosper in the 21st Century,*
> >
> > *the challenge of developing good job opportunities and preparing a workforce trained to fill them,*
> >
> > *the challenge of a federal government that in matters large and small takes unfair advantage of Indiana,*
> >
> > *the challenge of a health care system too costly, inefficient and closed to the middle class,*
> >
> > *the challenge of protecting our land, air, and water from those who would pollute them.*
>
> *Tonight, we face all these challenges and more. My friends, let us treat these challenges as opportunities.*

Making Do With Less

The challenge theme appeared in detail when governors talked about their budgets. Squeezed by their own determination to avoid, or at least minimize, tax increases, sluggish revenue growth, and deficits or other problems left from prior fiscal years, they discussed ways to manage better. As Ohio's governor put it, "We're going to have to work harder and smarter and do more with less." Rhode Island's governor talked of the need to "cut to make room" for higher priorities.

Children

Doing more and better in dealing with children was a theme in many messages. It was the centerpiece of the Pennsylvania message. The theme provided a basis for governors to talk about expansion of health services for children (partially federally mandated), preventive health, education, foster care, and prevention of child abuse.

Looking Good, The Exceptions

Governor Mickelson noted in his state-of-the-state that, unlike other legislatures, the South Dakota legislature would not need to spend the year on issues of survival. He devoted much of his address to chronicling the successes of individual businesses operating in the state and to success statistics like rapid employment growth and low unemployment. His major revenue proposal is to increase the state's take from gambling. The money would be used for property tax relief. Despite prosperity, the state has felt the forces causing greater Medicaid participation, with a recent increase in caseload from 32,000 to 52,000.

In Idaho, revenues continue to show rapid growth, ruling out any possibility of tax increases. The major fiscal concerns arise from changes in policy, not current policy: (1) a promised sharp increase in state school aid, (2) state takeover of indigent medical costs from counties, and (3) an initiative proposal to limit property taxes. Another major issue will be how to cope with the state's rapid growth, with local impact fees a possibility.

HOT ISSUES OF 1992

Hot Issues And Important Issues

Every year sees *hot issues* in the states. Some, such as school finance and employee pay, reappear because new decisions must be made each year. Others, like capital punishment and abortion, reappear because the public and legislators are closely divided about issues that they consider too important to compromise. Yet others, such as crime and dependency, reappear because the underlying problem isn't solved. These kinds of issues are the basis for media lists of hot issues NCSL's 116-page summary of its survey of legislatures, State Issues 1992: Priority Issues For State Legislatures, 1992.

There are also *important but less publicized issues* that affect millions of people in major ways, move billions of dollars, and from many perspectives reflect where state officials are having their biggest impacts. Many of these highly complex issues are understood and decided by small numbers of people largely ignored by the media. Reimbursement rates for health care providers, school aid distribution formulas, and how utility costs are shared between industrial and residential customers are examples.

Straightforward Budget Issues

> *The budget will dominate everything.*
>
> *There's no forum in government to discuss forward-thinking ideas. Everything is built on budgets, and we make next year's budget by looking at last year's.*

These kinds of comments are being heard in nearly every state as elected and appointed officials recognize how little space for policymaking exists in a tight budget year. It is particularly frustrating when their ideas are rejected by general decision rules like "no new initiatives" or "freezing spending at last year's level."

The first quote is from the Senate Majority Leader in Arizona. It faces a shortfall in its current budget, a shortfall in the current services budget for FY 1993, and a structural deficit for the 1990s. The legislature will be dealing with a no-new-tax governor and an environment of distrust of elected officials created by the recent impeachment of a governor and resignation of legislators associated with a nationally publicized bribery scandal.

The second quote is from the resigning superintendent of North Dakota's only state mental hospital, who is taking a job in Idaho. His concern is not so much money as his inability to close the facility, which once housed 1,000 patients but now has less than 300, and concentrate on community mental health care. He estimates that the cost per patient-year for residential treatment is now over $100,000.

Pulling Issues Into The Budget Process

There is no precise definition of what is a budget issue and what isn't. One operational definition suggests four tests. People are more likely to consider something a budget issue as it meets more of these tests: (1) the executive branch position is decided during the preparation of the budget, (2) decisions are reflected in budget amounts and appropriations bills, (3) the appropriating committees have some role in passage of the relevant legislation, and (4) no matter what process is followed in substantive legislation, the impact can be altered or reversed in appropriations legislation. In most states, this makes welfare, school finance equalization, and health care financing budget issues.

When policy decisions become expensive enough to disturb a legislature's ability to fund its major priorities, decisionmaking power may shift toward appropriating committees. This means shifting the vehicle away from separate bills and toward the omnibus budget bill used in some states or the budget "trailer" bill(s) used in others. For example, in State Issues 1992, NCSL calls the budget bill "increasingly the context in which decisions on corrections policy are being made in the states."

Pulling issues like sentencing policy, education reform, employee benefits, and community versus institutional mental health into the budget process has many critics. They include individual legislators with more power in subject matter committees than fiscal committees, interest groups, and the media which finds the fiscal decisionmaking process less open to scrutiny. By procedural rules in legislatures and provisions in state constitutions, attempts have been made to limit the gravitation of issues to the budget process. Rules that each bill deal with a single subject are examples. These rules haven't prevented the gravitation because legislative leaders typically insist that legislators agree to support the entire budget package, however many separate bills it may contain.

Budgets Displacing Other Issues

Leaders' Outlook suggests lower priority treatment for non-fiscal issues of concern to legislative leaders like reapportionment, economic development, campaign finance, ethics, and Workers' Compensation. It comments:

> *These issues, which would otherwise be at the top of many legislative agendas have largely been displaced in most states by basic budget concerns due to depressed revenues and spiraling costs for core programs.*

The sections below summarize what's happening in some of the other issues that will likely dominate the non-fiscal portions of the 1992 sessions.

Education Quality

> *I think we'll prioritize and do the things that we absolutely have to do. Once you get past that, I'm not sure you've got any money left.*

This comment from the chairman of the education finance subcommittee of the Kentucky House typifies the situation of many states. In Kentucky's case, what absolutely has to be done is to fund the school aid formula and previously adopted reforms. There may not be room for more, such as a 5% teacher pay increase, an addition to the school aid formula rewarding local tax effort, and more money for pupil testing.

Reform measures will certainly be considered. They have political momentum. Immense media attention has been given to criticisms of public education. The President, governors, Members of Congress, and legislators are all committed to reform. Massive efforts have gone into designing reform measures through the many conferences and task forces that have been dealing with the subject in the business community as well as in the legislatures and among educators. So large numbers of people have a commitment to reform and a stake in the outcome.

The Link Between Reform And New Money

The education quality programs of the 1980s stimulated debate between professional educators and elected state officials. The educators said it was meaningless to talk about reforms and quality improvement without providing adequate basic funding and addressing such expensive issues as class sizes and teacher compensation. Using phrases like "pouring water into leaky buckets," some state officials insisted that education would have to reform before they would support major funding increases. The usual result was to adopt measures that combined new funding with new quality measures.

It will be tough to repeat this pattern. Leaders' Outlook concludes "The education reforms of the next decade cannot rely on additional funding for success; rather, focus must be on spending current dollars better." State Issues concludes, "The survey results indicate that virtually every state will address education reform in the 1992 session."

But reform measures incorporating significant (and thus controversial) changes face obstacles. Many educators aren't likely to buy into reform without new money. Many legislators, up for reelection, often in newly drawn districts, aren't going to want to alienate professional educators on issues like school choice. Fresh money is the glue that can build coalitions to surmount these obstacles, but it often won't be there. In Arizona, the governor talks about finances by saying, "We've run out of wiggle room." The chairwoman of the House Ways and Means Committee is predicting that school funds won't increase enough to cover inflation. The new chair of the Arizona Senate Education Committee summed up the frustrations, "I've waited 15 years to be chairman of the Education Committee and now we don't have the money to do things."

Workers Compensation

Employer costs for worker injury and disability insurance have been growing rapidly relative to other employer costs, even state and local taxes. This has drawn employer interest to holding down Workers' Compensation costs and created strong resistance from employers and those interested in state economic development to anything that would increase costs.

Meanwhile, organized labor has been concerned that: (1) the system costs too much for employers trying to compete with firms in other states and nations, (2) benefits are inadequate by standards of tort law recoveries for similar injuries, current pay, or what disabled workers and their families need, and (3) benefits don't go to workers when they need them. Administrative procedures and litigation chew up months, even years, and leave injured workers with large legal bills. As a result, WC was a big issue in 1991. NCSL's State Issues summarized:

> *Much of the debate in 1991 focused on skyrocketing costs and legislative proposals designed to address them. Medical cost containment, excessive litigation, administrative reform, permanent partial disability, vocational rehabilitation and the development of an integrated managed care system were hotly debated. In California and Maine, Workers' Compensation reforms were so controversial that they became pawns in fiercely fought state budget battles.*

The last sentence of this quote isn't correct. Workers' Compensation issues were considered so important that it was the budget that became the pawn. Those advocating a particular WC position were willing to hold up entire state budgets until they prevailed in WC. In NCSL's survey of legislative staffers, WC far outdistanced other candidates -- such as unemployment insurance, worker training, plant closing legislation, and family leave -- for labor issue of the year.

Environmental Issues

Many environmental issues involve state regulation of private and local government activities with no direct interaction with state budgets. Often environmental programs carrying a state cost are enacted with user charges that cover the cost. As a result, there will be less constraint on policymaking in this area than in many others. Issues include hazardous waste disposal siting, nuclear waste disposal, the regulatory implications of fuel switching by utilities, pesticides, and groundwater protection.

Municipal solid waste will be high on state agenda because several aspects of current policy have problems. Standards for landfills are having the effects of driving up disposal costs, encouraging use of out-of-state disposal (thereby creating issues in the recipient state), and exacerbating illegal dumping. Landfill scarcity becomes a real prospect as half the nation's landfills may be forced to close because they don't meet new requirements. Recycling has worked in part and failed in part, creating the embarrassing prospect of encouraging a sizeable portion of American households to separate waste that will be recombined in landfills. As NCSL puts it in State Issues, "Americans are willing to make the effort to recycle their used products, but are unwilling to purchase recycled products in the marketplace."

Air quality standards will be a major issue in the Northeast. Environmental protection officials of twelve states have declared their intent to adopt the more stringent California standards for tailpipe emissions from cars rather than adopt by default the less stringent federal standards. Clean water costs -- both for drinking water and sewage collection and treatment -- have largely been shifted to state and local governments though the regulatory pressures continue to be applied at the federal level. Local officials would rather have state help than rely exclusively on local bonding, fees, and taxes for compliance.

Health Care Financed With State Money

> *This session's going to center on the budget, and if you have legislation that costs money you're in trouble.*

The state-of-the-state messages suggest that state elected officials will find health care too great a concern to be ignored this year. One result in the legislatures, as in the messages, will be an outpouring of discussion of the problems -- high and escalating costs, persons without coverage, and health results showing little difference between the high-cost American system and lower cost systems in other nations. But beyond evidencing concern and knowledge of the problems, what will legislators do?

The problem is illustrated by Kentucky. The quote above is from the Chairman of the Senate Health and Welfare Committee. His immediate problem is passing legislation to preserve the state's current activities. They have relied heavily on bootstrap financing devices that, under the new federal legislation, will not be allowed after June of 1993. His solution is a gross receipts tax on health care providers, with a 6% rate now being discussed. The state also faces cost increases associated with higher costs per Medicaid recipient, the likelihood of more recipients of existing services, and the federally mandated extension of eligibility to certain pregnant women and children.

Utah, with a reasonably strong economy, is in a better position to pay for health care proposals than many states. But in its preview of the legislative session, the Salt Lake Tribune (1/12) concluded that activity in the session will center on the conflict over limited state funds between education and programs for the poor like welfare and Medicaid. Its conclusion in health care may prove an accurate prediction for many legislatures:

> *The national debate over skyrocketing health-care costs and shrinking insurance coverage will also move into Utah's Capitol. But beyond a serious plan to add $2 million to a year-old program to insure chronically ill people who can't get private coverage, lawmakers will likely do little more than talk.*

The governors of Colorado and Indiana are beginning the legislative session where some other states will likely end it -- appointing a blue ribbon commission not due to report until 1993. States have a long history of task forces, study committees, and similar groups designed to find solutions. Iowa's Governor's Commission on Health Care Costs was established in 1981. Its Health Care Policy Corp. was established in the early 1980s to unite consumers, providers, and employers. It lasted until 1988 when the providers withdrew. In late 1990, the Iowa Leadership Consortium on Health Care was established. It has been discussing a plan requiring at least $100 million in new state money while the governor and legislators have been discussing what they must cut to make good on their no-new-tax pledges.

Health Care Financed Without State Money

One result of concerns over financing health care will be an outpouring of proposed laws mandating someone to solve some problem: (1) telling health insurers they must cover particular services such as mammography or mental health, (2) telling employers they must pay for health insurance for their workers, (3) telling physicians and other providers that they must accept Medicare payments as full payment, (4) telling providers they can't turn away patients because they can't pay, (5) telling insurance companies they can't refuse to write policies or charge extra for them because (a) there are expensive prior medical conditions, (b) the type of business has a history of high claims, or (c) the applicant is a small business or a household.

Absent cost controls in health care, which have not been a popular topic except in the context of universal health plans, all these mandates cost somebody money to pay for somebody else's health care. Having the taxpayer pay through tax credits is popular with health care proposal writers, but isn't doing well in the legislatures. Mandating a substantial levy on employers to be paid to health insurers ("play") or tax collectors ("or pay") is having the same problem.

Without these aspects, the mandates, even when couched in innocuous language like risk pooling, must be paid for out of someone's pocket. The candidates: (1) employers willing to pay for their own employees but not others, (2) organized workers who see costs put in their employer's bill as likely to reduce what they can achieve in wages and benefits, and (3) health care providers. These groups are more comfortable exercising their clout in the legislative process than going on television to explain why they don't like mammography or why they think cancer patients shouldn't get health insurance. As a result, health care legislation is likely to get considerable attention, but major enactments appear much less likely.

An Ohio proposal indicates how the process can develop. Its January 19 status was summarized by Columbus Dispatch statehouse reporter Mary Yost:

> *A fast-moving health care reform bill will be reigned back a little this week while proponents rethink provisions that came under attack last week.*

The concept is to improve insurance availability by mandating changes in insurance -- making it harder to deny initial coverage and to end coverage of small business, restricting how much pre-existing conditions can be excluded, and putting a ceiling on rate increases. Ohio's governor endorsed the bill in a November news conference, but with what some might have considered a minor detail to be resolved but which is a massive caveat in such proposals. The endorsement was conditioned on waiting for results of an actuarial study to determine the premium increase other employers would have to pay.

At the time, this number was assumed to be in the broad range of 2-9%. The actuarial study raised the range to 8-12%. A Blue Cross witness at a January House committee hearing sought to raise the number to 21%. These numbers were large enough to raise concerns that the bill would cause some employers to drop existing coverage, make Ohio industry and workers less competitive, and create a political backlash from organized business and labor. The House bill will stay in committee for more hearings and consideration of amendments.

Crime Control And Criminal Justice

Sentencing policy is likely to be the #1 criminal justice and law enforcement issue this year, according to NCSL's survey. But the preferred direction of policy change isn't obvious, so there may be little change. Reducing crime by making sentences stiffer doesn't appear to have made much of a dent in crime rates, though it hasn't lost its intuitive appeal. It has made a dent in state budgets, taking corrections from 1% of general fund spending to 5% in a decade.

Rising costs and doubtful effectiveness of longer sentences have made alternative sentencing proposals (e.g., shock probation, shock incarceration, community alternatives, early release) interesting. But there isn't enough experience with these alternatives to give legislators confidence in them. The obvious risk is that they will result in well-publicized heinous crimes by some people put on the streets by the new policy.

New York's law requiring a mandatory prison term for second-time felony offenses is an example. It affects primarily small-volume drug pushers who are themselves addicts. The governor called for repeal last year, but the legislature didn't act on the proposal.

As usual, there will be some issues in defining crimes and punishments that will attract media attention. Examples: assisted suicides, negligently leaving a gun where a minor has access to it, abortion, and capital punishment.

Transportation

It could be a quiet year for transportation legislation. State legislative action doesn't appear to be necessary this year in response to the major federal legislation passed last year, as North Dakota discovered by scheduling a special session and then deciding it wasn't necessary. Governors and legislators trying to maintain a no-new-tax or no-major-new-tax posture will skip action on gas tax increases until next year if they can. Some legislatures will be forced to discuss old mandates (e.g., motorcyclists' helmets) not yet adopted.

Regulatory Issues

Legislators have a potentially full platter of regulatory issues. Regulating solvency of insurance carriers, tort law reform including limits on punitive damages, and control of public utility rates, services, and competition are just a few. Although not necessarily the most important by any standard, the telecommunications issues are likely to capture media attention. The issues include regulating pay-per-call ("900") services, caller ID services, telemarketing, "junk fax," and rates.

Political Process Issues

Issues relating to the process of making decisions and the selection of decisionmakers are likely to highlight non-fiscal issues in most legislatures. More than half the states have **redistricting** to consider this year, a number that is likely to grow with court rejections of previously adopted plans. **Campaign finance** measures will be at issue in at least half the legislatures with sessions this year. The issues remain contribution limits, disclosure rules, and possible public financing.

Term limits have drawn interest nearly everywhere. **Ethics** measures are again on the agenda with particular urgency in states where there have been recent well-publicized problems. South Carolina reacted last year with a special session that produced a 151-page bill covering financial disclosures, lobbying rules, ethical standards, and mechanisms to enforce them.

Economic Development

> *We have learned that we are not living in splendid isolation. The real world for California is that we are in strong competition not only with other states but with other nations.*

With these words, Governor Wilson launched the Council on California's Competitiveness to be chaired by former baseball commissioner Peter Ueberroth. The blue ribbon advisory group will consider issues like Workers' Compensation, liability reform, and education. There are similar groups in many states, some formal and some informal. But there don't seem to be major legislative packages bundling together economic development funding, regulatory reform to benefit business, holding down insurance costs (e.g., unemployment, liability, and Workers' Compensation), providing relocation incentives, and reducing business taxes. Instead, proposals on these subjects are generally being offered and considered issue by issue.

Hottest Issues Of All

If the hotness of issues is appropriately measured in thermal degrees, then Idaho has the hottest issues of any state. They triggered a Statehouse fire that caused some $1.5 million in damages. By the same criterion, Michigan has the coldest issues based on the December rains that penetrated a leaky roof and damaged the governor's mansion. The tendency of hot topics to be centered on the budget is suggested by the fact that the Idaho statehouse conflagration was concentrated in the offices of the legislative fiscal staff.

Coldest Issue Of All

Problems of general purpose local governments (cities, counties, townships, and parishes as distinct from school districts) are likely to get least attention, to the consternation of local elected officials. They want more money from states, which most states aren't in a position to provide. Leaders' Outlook suggests that budget cuts are more likely for local aid than other major state activities.

Absent more state money, the local officials want more local taxing authority. The prospects for it may improve as other alternatives become increasingly discredited. Legislators aren't keen on taking the heat for balancing their state's budget without new taxes and also taking the blame for permitting local tax increases. Some governors -- such as Engler in Michigan, Weld in Massachusetts, and Wilson in California -- have extremely strong stands against increasing local taxing authority. Some such as Engler and Edgar in Illinois are pushing for new limits on local taxing authority.

Local officials also want relief from what they see as costly state mandates. There is some activity on this front, such as an attempt to repeal prevailing wage requirements in Massachusetts. But the big ticket mandates on drinking water, sewage treatment, and solid waste disposal are mostly federal mandates published on state letterheads.

Is This Trip Necessary?

Why not simply cancel all the scheduled legislative sessions this year? The idea isn't totally crazy. No regular sessions are scheduled in Arkansas, Montana, Nevada, North Dakota, Oregon, and Texas. In some states, like Indiana, the major legislative session is in the odd numbered year following elections and only a "short session" is scheduled in even numbered years. It is widely believed that a substantial segment of the public feels safer with legislatures not in session. Many citizen-legislators neglected their regular jobs last year because of lengthy sessions and the complexity and intensity of budget negotiations. Many legislators, particularly those in redrawn districts, want to spend lots of pre-election time with constituents.

When the dust settles, there will be relatively close convergence between what legislators absolutely had to do and what they did. Some legislation not on the must-do list -- such as comprehensive education reform, Workers' Compensation reform, and new health care finance initiatives, may not get done in many states. The must-do list seems to be short, except for the budget. Redistricting and/or ethics are musts in some states, but settled issues in others. Federal legislative changes have made revisions in Medicaid bootstrap financing a must in some states and a good idea in others. The revisions won't always be popular. They will likely be treated as part of the budget package nearly everywhere, thereby attracting the end-of-session urgency, leadership support, and votes needed.

FISCAL UPDATE

Introduction

State fiscal circumstances haven't changed since the reports in Issue 1 and 2. That's bad news. The national economy and state revenues haven't revived. Over-budget spending rates in AFDC and Medicaid continued. Current state spending exceeds revenue nearly everywhere. Between the holiday season and waiting for governors' budgets, there was essentially no action to close these gaps between December 15 and the end of January.

Latest Summary Information

The latest National Association of State Budget Officers survey, (Looking For A Light At The End Of The Tunnel) confirms the situation revealed by the legislators' survey covered in Issue 2. Words:

> *It isn't that the [revenue] estimates were overly optimistic; the economy is simply not performing at its expected level.*
>
> *While the recession is the main source of state fiscal stress, it is certainly not the only source.*
>
> *As their fiscal crises continue, states are now much more focused on longer term solutions ... States now perceive this downturn to be not just a matter of surviving a recession, but a matter of restructuring state government.*
>
> *The expectation ... is that there will be less inclination for states to rely heavily on tax increases [than in 1990 and 1991].*

Persistent deficits and the instability they cause may begin to give way to efforts to restructure, redefine, and reorganize state service delivery systems and the very services states deliver.

The numbers in the NASBO survey understate problems because four states didn't respond and California's response excluded key numbers, such as its deficit. Numbers:

States with Gaps in FY 1992 Budgets	27
Size of Reported Gaps in FY 1992	$5.8 billion
Size of Reported Gaps in FY 1993	$7.9 billion
Program Most Often Exempted From FY 1992 Cuts	AFDC, 9 states
Program Least Often Exempted From FY 1992 Cuts	Higher Ed., 2 states
Program Most Often Getting Extra FY 1992 Money	AFDC, 19 states
Program Least Often Getting Extra FY 1992 Money	Higher Ed., 2 states
States Considering Budget Cutting Strategies	
Eliminate Or Reorganize Programs	21
Layoffs	14
Reduce Local Aid	13
Furloughs	6
Privatization	4
States Admitting To Considering Tax Increases	4

The Losers

Higher education and general purpose (non-education) local governments appear the likely losers in the state budget battles of 1992. The state-of-the state messages didn't say this, but mentioned them much less than in past years. They are low on budget officers' lists for added money and high on the lists for subtractions. Leaders' Outlook says: "Cities that rely upon legislative appropriations for revenue sharing or other types of unrestricted aid may face more hardship." A table in that report uses local aid as the standard for budget cutting, reporting the likelihood of cuts in eduction is 45% of local aid cuts and of cuts in Medicaid 70%. The table doesn't distinguish elementary and secondary from higher education, but the text comments, "Higher education in particular may be subject to cuts."

Accelerating Capital Outlays

Some of the governors discussed ways to stimulate state economies in their state-of-the-state messages. Most called for doing better with existing resources (e.g., education results) rather than new programs. Some sought job stimulating programs, including proposals for new bond issues. At least one governor has given the proposals a title, "GEORGIA REBOUND."

While financing new capital outlays with bonds is an attractive way to accelerate economic recovery, it can bump into fiscal and political constraints. The fiscal constraint is clearest in states that have relied heavily on bonding in the past. One example is New York, where the governor recently announced that the state will abandon the practice of committing to five year plans for transit investments. Local transit officials contend that the absence of this commitment will impair their ability to obtain federal funds, though this isn't obvious to the governor's staff (or **Reports**).

Another example is New Jersey. In his state-of-the-state message, Governor Florio stressed state spending to spur recovery. But the plan avoids new financing from taxes or general obligation bonds. Money will come from: (1) sale of the state's interest in the World Trade Center buildings to the Port Authority of New York and New Jersey, (2) housing revenue bonds, and (3) existing transportation trust fund sources like the gasoline tax.

THE ASSAULT ON WELFARE DEPENDENCY

> *The growth in these programs has fueled tax increases, taken money away from road repairs and schools, and caused a structural imbalance in our budget that threatens our very ability to provide for people.*

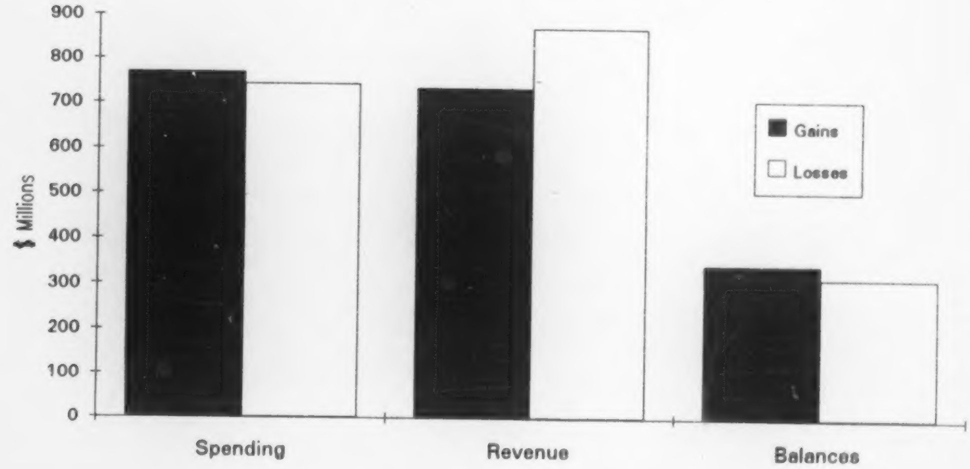
This line, from the New York Senate Majority Leader's response to the state-of-the-state message, is typical of increasing concern that welfare and Medicaid costs are squeezing all other state spending. This concern has been the main sticking point in trying to reach agreement on how to rebalance New York's FY 1992 budget.

Welfare Threatening Other Funding

Rapidly growing spending for welfare and Medicaid are forcing decisionmakers to consider changes in welfare policies. Elected officials are increasingly aware that, in a no-new-tax environment, having state income-tested programs grow by more than 10% while total spending grows 3-5% means education must grow less than 3-5%. The problem is hard to hide. Again this year, legislatures will be voting more money for welfare in supplemental appropriations at the same time they consider cutting other functions.

Budget Competition In Michigan

The problem with traditional budget adjustments is indicated by Michigan's actions to close its FY 1991 deficit of $1.9 billion, as shown on the chart. The complex series of budget adjustments boils down to cancelling spending overruns with spending cuts, cancelling revenue shortfalls with revenue increases, and offsetting negative balance adjustments with positive ones.



One Step Forward, One Step Back
Balancing Michigan's FY 1991 Budget

Additional appropriations (supplementals), primarily for income-tested programs like AFDC and Medicaid, raised spending by $743 million over the originally enacted budget. Appropriations reductions of $769 million were part of the budget balancing. So what was saved by spending cuts was about equal to what was lost by spending overruns.

The recession and other factors cut revenues $743 million below expectations, but one-time revenue items of $540 million and Medicaid bootstrap financing pumped an extra $734 into the budget. So revenue losses were about equal to revenue gains. Closing the books on FY 1990 brought $315 million of bad news into the year, but deferring some higher education spending moved $114 million in bad news out while tapping the rainy day fund moved $230 million of good news in. So adjustments to balances among years and among funds just about cancelled.

While nearly a wash in each of the budget categories, the changes weren't a wash program-by-program. The winners were the income-tested programs while other programs lost. As the problems carried forward to FY 1992, other programs were threatened again, along with taxpayers.

Because Governor Engler was committed to protecting both the taxpayer and education, his response was a cut in welfare. Michigan legislators were reluctant to accept the recommendations, but even more reluctant to accept the alternatives. The same forces explain themes of governors' budgets in California, Massachusetts, New York and elsewhere.

Cuts In Welfare Becoming More Common

The result is being seen by the media as a nationwide movement. This is indicated by headlines like "Surging Welfare Costs, Struggle To Control Them Join Health-Care Expense As Hot Political Issue (Wall Street Journal, 12/11), "States Yank Welcome Mat On Welfare" (Chicago Tribune, 1/11) and "California Plan To Cut Welfare May Prompt Others To Follow" (New York Times (12/13). Journalistic accounts usually cite Illinois, Maryland, Massachusetts, Tennessee, and Vermont, along with California and Michigan.

Cutting General Assistance

General assistance is cash provided by states (and in some states by local government) to persons who don't meet the tests for eligibility for federal-state programs -- persons who don't have children and aren't aged, blind, or disabled. Michigan's cutback last year got national publicity. There were also major cutbacks in Massachusetts, Ohio, and other states. A common cutback is to restrict the number of months a person can receive assistance.

Cutting AFDC Benefits And Eligibility

Most states have been cutting back on the purchasing power of AFDC benefits for two decades, partly because increases in Food Stamps and low-income energy assistance have taken up some of the slack. Last year, California cut its higher-than-average benefits. This year, Governor Wilson is taking an initiative package to voters in November. It contains proposals unlikely to be approved in the legislature -- a 10% benefit cut, a further 15% benefit cut for able-bodied recipients who don't find work, and a ceiling on benefits for new residents. They could receive no more than what they would have received in the state from which they migrated. A similar restriction on payments for new residents has been recommended again this year by governor Thompson for Wisconsin.

There are several proposals to discourage welfare recipients and potential welfare recipients from having children. The California proposal prohibits minors from getting state money to set up housekeeping by requiring that they and their child stay with their parents except in special circumstances. The lame duck session in New Jersey passed a measure that reduces grant increases for children born while the mother is already on welfare.

Cutting Special Needs Allowances

Each state's monthly welfare benefit is a known amount. It appears on a recipient's check and can be accurately tabulated to produce average and maximum payment statistics of the type that appear in States In Profile. Recipients also are entitled to Food Stamp vouchers and Medicaid coverage and may qualify for programs like subsidized housing, job training, and day care.

In addition, most welfare recipients get low-income energy assistance paid for by federal money, dedicated proceeds of certain price overcharge settlements with oil companies, and state funds. Cash is also paid to recipients or to vendors in many special needs situations that vary from state to state. Payments cover such needs as winter clothing, security deposits on apartments, replacement of appliances, moving expenses, extraordinary housing costs, and more. Because of considerable variation in these payments and the absence of reporting for them, it is hard to track changes in their use.

Fiscal pressures and a desire to disengage social workers from the day-to-day decisions of recipients have produced interest in eliminating or curtailing special needs programs. Michigan is an example of a state that has done this while Rhode island may become an example of a state doing it this year.

Look Twice At Welfare Reform In New Jersey

> *What this does is give welfare recipients a choice. They either can have additional children and work to pay the added costs, or they can decide not to have any more children. It's their call and a decision that puts them in the same position as anyone else in mainstream America who must choose among options.*

This is the New Jersey House Majority Leader's description of a newly adopted plan to prevent increases in welfare grants for welfare mothers who have more children. While this idea has been discussed in many states, New Jersey is the first to pass it.

It is easy to dismiss New Jersey's welfare reform package. It is "welfare reform" which makes it sound like other reform proposals such as those in California, Michigan, and Wisconsin. It was passed in a lame duck session with a Democratic majority that has now become a minority. It wasn't the main act or even a widely noted sideshow in a session marked by attempts to repeal the Garden State's major tax increases and by a constant battle by Democrats to keep a quorum and by Republicans to prevent one.

Politically, the package had something going for it. Its leading proponent was a Democrat, a legislative leader (House majority leader), and a representative of an area (Camden) that has about the largest percentage of welfare recipients and the lowest incomes in the state. It was supported by large bipartisan majorities despite opposition from church groups, the American Civil Liberties Union, and others. The main bill passed the Senate and moved to the governor's desk by a vote of 27-1. Controversial provisions subject to separate votes passed by margins of 22-4 and better. The governor signed it enthusiastically, commenting, "This ought to be a policy nationally." He criticized the current welfare system as "corrupt" and "morally bankrupt."

The legislation was sold as being pro-family and not punitive. The intent is more to save families and children than to save money. The major savings are associated with denying an increase in cash benefits for a mother having children while on welfare. Medicaid and Food Stamps would both cover the added child. There is also a work requirement, but like other work requirements its impact will depend upon implementation.

A key change is in treatment of additional household income. Wayne Bryant, the key sponsor, describes current law as a marriage penalty, which it is. For complex reasons, he argues there is now a penalty on married non-working parents. New Jersey, and other states, consider the income of a new husband in determining household need. So when a woman on welfare marries someone with a job, both the welfare payment and associated benefits are lost. The new law would, in effect, disregard his income up to certain thresholds, such as $20,100 for a family of four.

The bills violate many federal welfare rules, so waivers will be required. Bryant, who has met with White House officials on the subject, expects approval this spring.

SCHOOL FINANCE EQUALIZATION

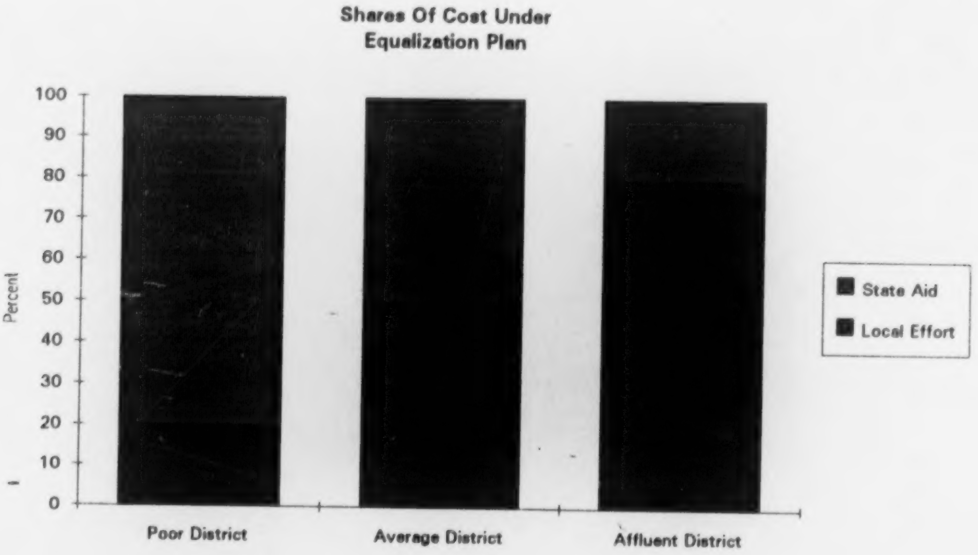
> *School finance reform is like a 19th Century Russian novel. The story line runs across generations, the plot is complex, the prose is tedious, and everybody dies in the end.*

Controversies over school aid equalization will be affecting state decisions this year in many ways, with considerable variation among the states. The political hazards are captured by the quote above which is often heard in discussions of the subject.

It is hard to overestimate the impact of equalization issues on state finances. Much of the impetus for New Jersey's tax increases came from equalization. So did recent tax increases in Kentucky and Texas. Fear of court-mandated equalization is a major factor encouraging Tennessee to adopt an income tax this year. NCSL's survey of legislative leaders indicated at least 18 states will debate school aid formula changes this year. About half the states are engaged in litigation over the equity of their school aid formulas.

How Equalization Works

Every state makes some attempt to equalize the spending ability of districts of differing wealth. The concept is illustrated by the chart. The local effort component is defined by a logic, such as a property tax of 1%, applied to each district to determine what it should raise. The minimum program is defined by another logic, such as so much per pupil. State aid fills the gap between the minimum program and the local effort.



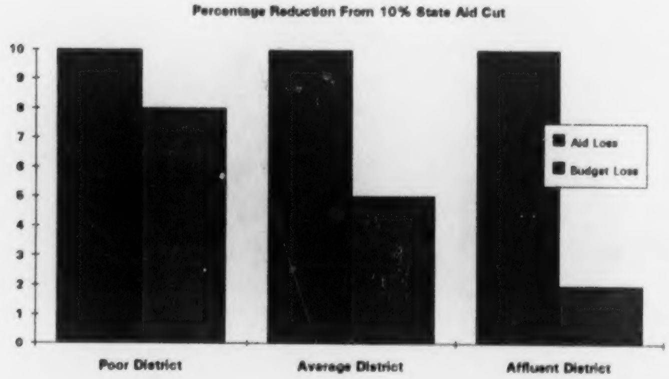
Controversies Over Equalization

Against the standard of equal per pupil spending capacity for districts of differing affluence, most state equalization plans are subject to attack -- on equity grounds in the legislature and on constitutional grounds in the courts. The equalization standard is violated in many ways. Some "out of formula" districts are so affluent that they can spend more than the state standard with a lower tax effort than required by the formula even when they get no state aid at all. For these districts and others, the formula's logic is violated by hold harmless provisions and guarantees of minimum per pupil amounts. Major cost categories, such as school construction, are often left out of the formula. Some states don't consider differing local tax capacity when paying certain costs, such as teacher retirement and special education, outside the formula.

To complicate matters, there are differing views on the appropriate ways to measure elements in a formula. Measuring local effort by the property tax base is common, but doesn't reflect differences in ability to pay as measured by income. It may be unfair to consider two districts equally just because they have equal tax bases if one shares the base with an expensive central city while the other is in a rural area. There are also controversies over measuring the minimum program the state guarantees. For example, should high school and vocational students count more than regular students? Another problem is what to do with affluent districts that go beyond the minimum program by local vote. Should they be permitted to do this at all? If so, should they have to share their added revenues with other districts?

Equalization And Cutting The Budget

Equalization considerations are also creating controversies in the many states applying percentage cuts to much of their activity including across-the-board cuts in school aid.



As shown at the left, the impact of cuts on schools depends upon how much each district relies on state aid. A 10% aid cut causes only a 2% cut in the budget of the affluent district, a 5% cut in the average district, and an 8% cut in the poorest district. This arguably puts disproportionate hardship on the poor district and clearly defeats the logic of the state's equalization effort.

This issue is being faced by every state that has had to reduce school aid. It was addressed in Maine in January as part of the FY 1992 reduction package. The legislature decided to mute the impacts that would result from equal percentage reductions of state aid by making larger reductions in the more affluent districts. The same issues have been at stake in the Massachusetts cuts over the last several years. They are a part of the impasse over budget cuts in New York.

Raising School Aid

The issue of how to allocate additional money for schools arises each year. It has a special element in states that are seeking to move toward more equalization in school finance without litigation. In Virginia, the Coalition for Equity in Educational Funding has withdrawn its school finance lawsuit. Its leaders indicated they were responding to a "strong commitment" to school finance reform by legislative leaders. But there do not appear to be specific promises on formula changes and there clearly is no commitment to seek higher taxes to finance reform. Virginia legislators hinted they were less likely to act while a suit was pending than if there were no litigation. The state's plan will presumably provide larger increases each year for poor districts than for affluent ones until an equalization target is reached. Such a plan is more easily summarized than drafted.

Continuing Agony In Texas

> *Texas school finance is not a Russian novel. It's more like a Greek tragedy. The public schools are dying, and the means of salvation are at hand, but the gods who are supposed to watch over these things have lost themselves in bickering and evasion.*

This assessment from the lawyers contesting the latest Texas school finance plan summarizes some of the problems that continue to dominate the Texas budget, tax policy, and to a significant degree, politics. In prior chapters of the novel (or acts of the play), the state supreme court has rendered two equalization decisions. The legislature has sought to provide equalization by providing additional state money, including money from raising taxes, concentrated on poorer districts. It also produced billions of property tax increases by setting a minimum property tax level and spreading the property tax base from a district basis to a county basis. The plan went back to court with rich districts (the "Robin Hood Forum") challenging the county tax arrangement as a disguised form of statewide property tax that is prohibited by the state constitution.

The governor warned the state supreme court of possible school closings if it rejected the new plan. In commentary on a pending case that is unusual in most judicial systems, she sent a letter to each justice. Legislative leaders sent the same message by press release. The chairman of the House Education Committee suggested that if the court invalidated the current plan, it should figure out its own substitute plan. The governor's letter to the justices commented, "It would not be productive to call members back to Austin for a special legislative session again to address the issue of public school finance in an atmosphere of crisis and contention."

Besides this pressure, many justices face reelection in November. In a divided late January opinion, they decided that the new plan was an unconstitutional statewide property tax. But there will be no pre-election crisis. Districts can keep the money they collect and the legislature has until June of 1993 to enact a new plan. Devising a new plan acceptable to the court will be extremely difficult without resorting to one of two unpalatable alternatives: (1) seeking voter approval of a statewide property tax or (2) a massive infusion of new state money requiring highest-in-the-nation sales taxes or enacting an income tax.

TAX CUTS

While fiscal problems suggest tax cuts won't be a major state issue this year, there is some activity. Much comes through voter initiative measures, such as those in Colorado and Idaho. Among elected officials, interest in tax cuts has been confined primarily to proposed limits on local property taxes (e.g., Illinois and Michigan) and narrow business tax reductions (e.g., Delaware). The exceptions are Massachusetts and New Jersey.

The Second Massachusetts Miracle? Ending speculation on how he would handle a gap of more than 10% of the FY 1993 budget, Governor Weld proposed a $200 million increase in school aid and cutting: (1) the personal income tax rate, (2) the tax on capital gains, and (3) corporate taxes through several tax credits, including a credit of nearly 100% of the first-year employer cost of creating new jobs. Initial discussion centered on whether the mathematics of the budget was credible, rather than on the merits of the tax proposals.

Tax Repeal In New Jersey: The Democratic legislative majority passed a major tax increase that led to the Republican landslide in 1991. Most winning Republicans criticized the increase and promised to repeal the sales tax portion, but not the entire package. Democratic leaders tried to repeal the package. The new Republican majority could reenact the package, thereby becoming the party that raised taxes. The tax increase was earmarked for specific items such as school finance reform and property tax relief. When recession hit, state finances suffered despite the tax increase. The FY 1992 budget is balanced only with one-time items. With recession continuing and a need to replace revenue from the one-time items, one estimate of the FY 1993 budget gap is $2 billion out of a budget of about $15 billion. Legislators spent the better part of December and early January debating repeal. It passed one House but barely failed in the other as a few Democrats defected.

TECHNICAL NOTES

Workers' Compensation: As the annual indices reveal, Reports has often assessed WC reforms. More than in any field, other than capital punishment and selling state liquor stores, the issues don't seem to change, new analyses aren't providing new insights, and new data don't indicate new patterns or trends.

School Finance Equalization: The Russian novel quote probably originated with Denver-based school finance consultant John Augenblick who has helped write many of the state school aid formulas. The quotation on Texas school finance is from an OpEd by James George and Hugh Lowe that appeared in the Austin American-Statesman (12/20).

Corrections And Revisions: In the table comparing per capita tax burdens on p. 15 of Issue 1, all of the numbers and rankings are correct. So is the national average of $2,016, but it should have been inserted after the 16th state rather than after the 11th.

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STATE POLICY REPORTS

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IN THIS ISSUE

Governor Weld of Massachusetts is often drawing national attention. The reasons shed light on policy issues in all states. One reason is applying supply-side concepts to states, including pushing for tax cuts in a depressed economy. Another is emphasis on prevention, and the linked theme of investment. Yet another is "entrepreneurial government," the topic of a new must-read book. It offers concepts and phrases, like *empowerment*, that are becoming more popular in many states -- perhaps indicating a *paradigm shift* in how states are run.

- A Star Is Born p. 2
- Supply-Side State Policies p. 3
- Entrepreneurial Government p. 4
- Unleashing The Paradigm Shift p. 5
- Prevention And Investment p. 10

Paying for health care has become increasingly important to the public and to state and federal officials. All the evidence suggests that health costs will continue to consume larger and larger portions of the nation's income. State officials aspire to solve some of the resulting problems, but the solutions may prove beyond their reach.

- Financing Health Care p. 11

In the midst of mediocre to rotten economic and fiscal circumstances, one might guess that cuts in state taxes would be out of the question. There may be exceptions, mostly for business.

- Fiscal Conditions Update p. 17
- Tax Cuts For Business p. 18

Besides trying to stimulate development with business tax cuts, some states are using pension funds and idle cash. Doing this has risks, but so does not doing it.

- Investing Pension Fund Assets p. 21

Technical notes examine detail sources and caveats.

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February 1992 (Second Of Two February Issues)

A STAR IS BORN

> *When William F. Weld took office as the first Republican governor of Massachusetts in 16 years, he faced a hostile Democratic House and Senate, a dead-battery economy and a daunting budget deficit.*
>
> *Thirteen months later, despite the misery of slashing government programs in recession, Weld is winning generally high marks for balancing the budget while holding firm on no new taxes. He also is proposing going one step beyond fellow governors by cutting taxes.*

This Washington Post (2/12) assessment is typical of the national media attention Governor Weld has been receiving. Some of the attention is based on non-economic issues and politics. Weld's story is more intriguing because he is reversing policies of Governor Dukakis, the 1988 Democratic Presidential candidate, and because he is mentioned as a possible opponent of Senator Kennedy in 1994 and candidate for President in 1996. His support of abortion rights, gay rights, and the right to bear arms gives him interesting other positions to accompany his fiscal perspectives.

Most of the attention is because of his fiscal policies, a potential model for the nation. As the Wall Street Journal (2/5) put it: *If William Weld can end the tax-and-spend cycle in liberal Massachusetts, then surely the governors of more fiscally moderate states can recapture control of their states' budgets.*

Weld's tax-cutting record is perfect so far. In 1991, he induced the legislature to repeal the sales tax on professional services before any money was collected and obtained approval of research tax credits. He prevented the legislature from giving local governments new ways to avoid the property tax limits of Proposition 2 1/2 and from extending an income tax surcharge. So the tax dropped on schedule in January. His new budget seeks cuts in the personal income tax rate, capital gains taxes, and corporate taxes.

His budget offers what many governors would like to offer -- tax cuts, large increases in school spending, and a balanced budget after years of deficits. His standing in the polls, more than twice as many favorable impressions as unfavorable, contrasts with much lower popularity of governors like Wilson of California and Cuomo of New York.

National Recognition, A Blessing? Being a new governor spotlighted by national media, as Governors Weld and Engler (R, Michigan) now are, doesn't presage success in office. In the year after their election, Governors Mabus (D, Mississippi) and Roemer (D, Louisiana) were featured as a new wave of bright, well-educated governors leading their states to new heights in economic development and education while demonstrating modern management styles. Both were defeated in their 1991 reelection tries. In 1990, the governors with the widest reelection vote margins were ones that received little national media attention -- Campbell (R, South Carolina), Casey (D, Pennsylvania), and Andrus (D, Idaho).

SUPPLY-SIDE STATE POLICIES

If you believe in controlling growth of government, the best way to do it is to take away the revenue.

One of the ways to keep spending down is to keep money away from government.

Supply-Side Economics: Such comments were common in the early 1980s when the concepts of *supply-side economics* were being debated as national policy. They were reflected in President Reagan's first budget and tax recommendations which were largely adopted by the Congress in 1981 and have affected federal fiscal policy ever since. While there is more than one definition of the concept, one tenet is that government -- through taxes, spending, and regulation -- retards the growth-creating forces of the private sector.

In the imperfect world of government policymaking, reining in taxes and spending simultaneously isn't always possible, particularly when a supply-side chief executive is dealing with a legislative body that doesn't share his views. So the concept is to wrestle the tax-and-spend beast to the ground by grabbing whatever part can most easily be grabbed. Because public opinion supports spending more than taxes to pay for it, cutting taxes is a prescription for cutting government. The right taxes to cut are those on suppliers of labor and capital -- the personal and corporate income taxes, including capital gains taxes.

Supply-Side In The States: Cutting taxes with the idea that spending will eventually follow is tenable for the federal government, which can operate with unbalanced budgets. Because of balanced budget requirements, there isn't usually a need to distinguish between whether to cut state taxes and then spending or cut spending and then taxes. The movement for constitutional restraints on state and local finances produces what policy watchers call tax ***and*** spending limits. The distinction between limiting taxes and limiting spending is usually so unimportant that few people know which of the effective limits -- such as the Gann Amendment in California and the Hancock Amendment in Missouri -- limit spending and which limit taxes.

Supply-side rhetoric is appearing in the states this year, and getting lots of national attention. Governor Weld made the first comment quoted on this page when he was showcased, along with Governor Engler of Michigan, at a February seminar held by the conservative CATO Institute. The second quote is from Weld's press secretary defending his budget to the Boston Globe (1/23).

Supply-side perspectives are affecting the few tax cuts being considered in the states. They are concentrated on personal income taxes (e.g. Arizona, Massachusetts, and Pennsylvania) and corporate taxes (Massachusetts, Pennsylvania, and many other states).

ENTREPRENEURIAL GOVERNMENT

"Entrepreneurial government" is one phrase used to describe what the Weld Administration is trying to accomplish. Its Bible has just been published by the consultant/journalists (David Osborne and Ted Gaebler) who have been pushing its perspectives in Arkansas, Florida, Massachusetts and elsewhere. Reinventing Government: How The Entrepreneurial Spirit Is Transforming The Public Sector (Addison-Wesley Publishing) gets rave reviews from Governor Weld (*required reading in the Weld Administration)*, Governor Clinton (*should be read by every elected official in America*), and syndicated columnist Neal Peirce (*best primer yet on how America's governments can survive the fiscal agonies of the '90s*).

The book is more about management than policy, more about attitudes than individual decisions -- "It focuses not on what government should do, but on how government should work." As its dust jacket comments, "Reinventing Government is not a partisan book ... its ideas have been embraced by both liberals and conservatives, Democrats and Republicans."

The book, and Osborne's ideas, are getting enthusiastic press attention, typified by the headline in the New York Times (2/17), "Exponent of Government-as-Business Is Gaining Bigger Audience." The article credits Osborne with a decision by Governor Chiles that freed some of Florida's largest agencies from their cumbersome rules, quickly raising productivity. He is also given credit for money-saving changes in the Medicaid program in Massachusetts. Such reviews will draw even more interest in state capitols as readers see that reviewers like the Times perceive Osborne as offering painless budget-balancing:

> *What Mr. Osborne would do, at a time of widespread fiscal crisis, is to cut costs without eliminating essential services through a more imaginative and efficient approach to government. To some extent, he wants to make government run more like business.*

The 405 pages of Reinventing Government are highly readable. They are filled with real life examples, catchy phrases, dramatic quotations, analogies (e.g., "We need an American *perestroika.*") and nifty nice-sounding generalizations like, "we need *better* government. To be more precise, we need better *governance.*" Rigor is the price paid for readability. Critical readers will leave the examples wondering whether anyone was opposed to what was done, why they were opposed, and if there was follow-up evaluation.

Some concepts may be new insights. Others wrap old ideas in new packages, which can help if good old ideas have gotten bad names by botched implementation. The concepts can be slippery in specifics. For example, Governor Weld is touting zero-base budgeting. Osborne calls zero-base "too cumbersome." The two are probably talking about different budgeting systems (See Technical Notes).

The book is like the passage from Governor Wilson's 1991 inaugural address quoted on its concluding page.

> *We will not suffer the future. We will shape it. We will not simply grow. We will manage our growth. We will not passively experience change. We will make change.* ***But to shape our future, we need a new vision of government.***

Both the book and the quotation have thoughts readers would agree with, though they might express them differently. But the book and the inaugural message lend more inspiration than guidance for dealing with the individual decisions faced in Wilson's California and elsewhere.

After finishing the book, readers are likely to ask, "now what specifically do I do to implement what I have learned?" They won't find advice on current budget-balancing issues like whether to slash general assistance rolls, cut universities and raise tuition, revise school aid formulas, or try to limit hospital reimbursement rates.

But the authors seem to have anticipated readers looking for specifics by providing a chapter that applies their principles to health care, education, and criminal justice. Readers looking for non-controversial, money-saving quick fixes will be disappointed. The three page discussion of health policy opts for the German system, including universal coverage through mandates of employer coverage and public subsidies for the unemployed poor. Education would be restructured by giving parents choices of schools with the hope that the result would be as good as Catholic schools which produce "far better results for far less money than comparable public school systems." Crime would be attacked by shifting power from separate systems of police, prosecutors, courts, and corrections to regional bodies resembling the Private Industry Councils now used for job training. These may or may not be the right prescriptions. They aren't easy fixes.

UNLEASHING THE PARADIGM SHIFT

> *In government after government and public system after public system, reinvention is the only option left. But the lack of a vision -- a new paradigm -- holds us back. We hope the vision we have laid out will unlock the remaining gates -- unleashing a paradigm shift throughout American government.*

This passage summarizes Osborne's hope that readers will unleash a *paradigm shift* {probably welcome news for those who previously worked for *sea change}*. Whether readers do this or not, they need to recognize the *vocabulary* of entrepreneurial government if for no other reason than to present their old ideas effectively. To do this, they need the "ten simple principles" of Reinventing Government summarized in the next four pages.

> *Used almost as a checklist, the ten principles offer a powerful conceptual tool. One can run any public organization or system -- or any of society's problems -- through the list, and the process will suggest a radically different approach.*

CATALYTIC GOVERNMENT is governing by managing, not doing, *steering rather than rowing*. When governments do things, they are *monopoly suppliers* and become inflexible and inefficient. Government should be a buyer, not a performer, of services. Governments become *steering organizations* to deliver funds and evaluate performance. The key is *leveraging* private resources and using the private sector for what it does best, producing goods and services. This way governments can be *smaller but stronger*. There are 36 alternatives for doing this including *avant-garde* ones like *seed money* and *equity investments* by government. Progress will require forcing change on interest groups, such as teachers and doctors, to *restructure institutions and markets*.

Government should let *competition* energize its suppliers -- rewarding *experimentation* and *comprehensive solutions*, such as *holistic* strategies. Privatization, as a grand ideology, isn't right, but having things done by contract is. The thought that government and business should be separate is "an outdated mind-set." There are not just two sectors of the economy, private and public, there is the *third sector* of institutions that are private but don't exist to make a profit -- religious groups, Blue Cross, and United Way organizations. Like firms, they are potential performers of government work,

Examples: revitalizing St. Paul and Indianapolis, mental health in Ohio, Oklahoma Futures, and contracting out mental health in Arizona. Examples of what not to do: government payment of 40% of health bills without shaping the market and spending $500 billion on the savings and loan bailout without influencing where the money went.

EMPOWERMENT should appear through *community-owned government*. It is an American tradition already reflected in Little Leagues and Scouts, *self-help organizations*, but lost when government acts by creating programs, clients, and dependency. Ownership and control of public services should be pushed *out of the hands of bureaucrats and professionals, into communities*. Communities are better than professionals because they have more commitment to those served, understand their problems better, are more flexible and cheaper, enforce standards of behavior more effectively, and are oriented to solving problems rather than delivering services.

Examples: *community-oriented policing*, tenant committees in public housing, local school control in Chicago, the Arkansas home instruction program for preschoolers, paroling prisoners to the Salvation Army in Florida, the hospice movement, and job retraining in Massachusetts. What not to do: urban renewal, deinstitutionalizing mental patients but not funding and monitoring community care, and public housing.

***COMPETITIVE GOVERNMENT** injects competition into service delivery.* Not competition among policy agencies (just turf wars), but competition among those delivering services. Not competition among individuals, like merit pay for teachers, but competition between organizations, like merit pay for schools. Competition leads to efficiency, more bang for the buck, and rewards innovation. Without competition, franchised private monopolies like public utilities aren't necessarily better than public monopolies.

Examples: Minnesota's school choice experiments and competition between public employees and contractors to collect trash in Phoenix and run Tennessee prisons. What not to do: the Postal Service and preventing auto insurance price competition in Massachusetts.

MISSION-DRIVEN GOVERNMENT is focused on objectives, not rules. It works while *rule-driven organizations* don't. Entrepreneurial leaders do away with obsolete regulations and programs. They use a *mission-driven budget system* rather than line items. They *marry their budget systems to performance measures.* They junk *rule-driven personnel systems.* They break large agencies into small groups by *chunking* and spin off new teams by *hiving.* They *reorganize around mission, not turf.* With a clear mission, *leaders build a culture around it.* They *create permission to fail.* Without it, authority is lacking to do things right.

Examples: a Louisville housing agency with no employees, quasi-public corporations for economic development and job training in Massachusetts, waivers of rules for school districts in Washington, and doing without a civil service system in Texas. What not to do: the two-volume rule book for New York City schools and state laws requiring upholstery tags to protect against problems with horsehair that hasn't been used in 50 years.

RESULTS-ORIENTED GOVERNMENT focuses on *outcomes, not inputs.* Hallmarks are *accountability, performance, and results.* Performance measurement is key because *what gets measured, gets done.* Asking nothing of welfare recipients except that they stay poor, *rewards failure* and *breeds dependency.* The solution is *mutual obligations*, building *demands for performance* into poverty programs. The public supports funding when *spending is conditioned on results. Management By Results* is better than old ideas like Management By Objectives or Management by Guesswork. *Total Quality Management* combines a results orientation with worker participation, making it "an extremely powerful tool." The budget system must be *mission-driven, decentralized, and results oriented.*

Examples: the Illinois reimbursement system for nursing homes, nine states that tie vocational education funding to placements, rate regulation that rewards utilities for operating efficiently, management through performance standards in Wisconsin, "Learnfare," and cooperation of the President and the governors in setting education goals. What not to do: federal drug enforcement programs, giving police departments more money when crime rates rise, and California with "400 commissions that spend almost $2 billion a year."

CONSUMER-DRIVEN GOVERNMENT replaces *one-size-fits-all services* with services tailored to meet individual needs by letting citizens choose and through consumer surveys and focus groups. *Putting customers in the driver's seat* can be done by giving them control of the purchasing decision through *vouchers* like Food Stamps or the GI Bill. *Customer-driven systems* force service providers to be more accountable, take politics out of selecting who provides services, promote innovation, match supply and demand, and give consumers choices. *Empowering consumers* promotes equity better than funding suppliers. For example, rather than funding state universities serving primarily middle and high income students, give equal value vouchers to all potential students.

Consumer-driven systems should be *user-friendly*, *transparent* (like electricity, so consumers don't have to figure out the bureaucracy to get the service), and *holistic* (dealing with the whole person and whole problem) with *one-stop shopping*, *single intake systems*, and *case management* systems. "A time will come when people won't believe that a pregnant high school girl in America once had more than a half a dozen different caseworkers" or parents "could not choose the public schools their children attended."

Examples: self-service computerized terminals for drivers' license renewals in California, a Wisconsin community college handled such problems as cancelled classes with modules of three weeks rather than semesters or quarters, and voucher-like devices for child care in Connecticut. What not to do: long lines at licensing agency offices and Governor Engler's decision to drop the Michigan job training system.

ENTERPRISING GOVERNMENT thinks about making money, not just spending it. It relies heavily on user fees and makes arrangements for the poor rather than subsidies for everyone. It has an investment perspective, *spending money to save money. Turning managers into entrepreneurs* can be accomplished by letting agencies and even employees share in the savings and earnings they generate, budgeting *innovation capital, enterprise funds,* and public authorities like airport authorities. These can become *profit centers* even competing with private business. To do this, governments need to know their *true costs.*

Examples: the money-making Los Angeles Olympic Committee, cities that sell sewage sludge and unfilled jail beds and share in real estate projects, investments in tax auditors and Head Start, and charging for responses to false alarms. What not to do: a Minnesota legal decision limiting royalties the state collects on software it developed.

ANTICIPATORY GOVERNMENT stresses *prevention rather than cure.* It anticipates problems and opportunities, rather than *lurching from crisis to crisis.* It uses *anticipatory democracy* such as futures commissions, employs *strategic planning* that *permeates the culture of an organization*, and makes decisions based on building *consensus.* This takes *long-term budgets* that marry budgets and planning and allow leaders to be *proactive rather than reactive, cross-departmental budgeting* showing one agency's impact on another's cost, accrual accounting with depreciation, and metropolitan governments.

Examples: fire prevention, gun control, prenatal care, new governors who "have made prevention a central theme," preventing homelessness in New Jersey, budget projections in California and Florida, and fiscal notes. What not to do: getting into debt and a Florida long-range planning system which "quickly degenerated into makework."

DECENTRALIZED GOVERNMENT moves *from hierarchy to participation and teamwork* because decentralized institutions can respond better, be more innovative, and have greater morale. Entrepreneurial leaders *return control to those who work down where the rubber meets the road* by *decentralization* and *participatory management* including *site management* like pushing authority from school districts and state agencies to schools.

These leaders improve labor-management relations, recognizing much of the problem is with management, not workers or unions. They adopt a *no layoff* policy using 10% annual attrition to adjust workforces. They *flatten the organizational hierarchy* by getting rid of middle managers who cause *overcontrol.* They use *teamwork* in *task-oriented organizations* that change structures and procedures as tasks change -- *innovative organizations.* They champion *bottoms-up innovation as* "those at the top must often change the rules before those at the bottom can innovate." They improve the employee's situation which automatically improves productivity rather than efforts to improve productivity which "usually undermine both productivity and morale."

Examples: Desert Storm, quality management in municipal waste collection and motor vehicle maintenance, a Minnesota program designed to listen to employee ideas, and Pennsylvania's Ben Franklin Partnership. What not to do: central management of the Vietnam War and federal overcontrol of state and local government.

MARKET-ORIENTED GOVERNMENT shapes private conduct by a *noncentralist approach,* using market forces, *leveraging change through the market* rather than by establishing a program. *Structuring the market* isn't new. Government has always structured legal markets -- "Next time you hear someone condemn government and glorify the free market, ask him if he really means to hold the drug trade up as a model." Markets beat programs because programs are driven by constituencies not customers, by politics not policy, have turf, create *fragmented delivery systems*, aren't self-correcting, use commands rather than incentives, infrequently achieve appropriate scale, and rarely die.

Governments can *restructure the marketplace* by rules like zoning, providing consumer information, encouraging demand (e.g., vouchers), encouraging new supplies (*catalyzing private sector suppliers*). They can fill market gaps by actions like making loans to small business, encouraging new market sectors like HMOs, sharing risk with the private sector, mobilizing capital from pension funds, raising taxes to discourage use of alcohol and tobacco, and adopting user fees including peak-load pricing.

In regulation, government should apply *market-oriented thinking* rather than a *command-and-control strategy* that is slow, discourages innovation, is extremely expensive and inherently focuses enforcement on large organizations and on symptoms rather than causes. *Green taxes* (such as on pollutants emitted) are better than *all-or-nothing regulation*. *Restructuring markets within the public sector* is also appropriate.

Examples: emissions trading in pollution control, vouchers and tax credits for child care rather than funding day care centers, mandatory deposits on containers, no fault insurance, impact fees for developers, and taxes on pesticides and fertilizers in Iowa, Minnesota, and Oregon.

PREVENTION AND INVESTMENT

Taking The Long View: The concepts of spending to prevent future costs and investing for future benefits aren't new. They appear in the Puritan ethic, in advice of parents to children, in cost-benefit analysis, in public health doctrines, and elsewhere. They are a common theme of many new governors.

Prevention Versus Care: Many state officials are saying that priority should be given to preventive health relative to treatment. Typical statistics:

> It costs $100,000-200,000 to treat an AIDS case, but $10,000 to prevent one if a $10-per-person education program works in one of a thousand cases.
>
> Prenatal care costing $2,000 can often prevent birth problems ultimately costing $100,000 and more.
>
> Lifestyle changes, like diet and exercise, encouraged by health education can reduce (or at least postpone) the need for costly treatments.

State health spending is heavily oriented to treatment, not prevention. Medicaid hospital and nursing home spending exceeds other health care spending by a wide margin and is growing faster. In a January speech to the National Press Club, Governor Wilson used California's inability to find much money for prevention as an illustration of how federal mandates distort state priorities.

Governor Weld requested $24 million in his tight new budget for eight prevention initiatives. They include expansion of the WIC program, early intervention for disabled disadvantaged youth, more prenatal care, and several AIDS-related programs. The package also has new money for family planning centers losing federal funds because they won't follow the "gag rule" that prevents them from talking about abortion. Governor Wilson proposed a program (CHECK UP) for non-Medicaid children up to age five.

Investments: Governor Engler's budget places heavy emphasis on education, including "*investing* $3.5 billion in our K-12 schools." It describes the priorities used to determine the budget as including "building a foundation for the future" by maintaining the commitment to education and by repairing the state's aging infrastructure.

Investments in children are also characterized as the priority in the California and Massachusetts budgets. Encouraging business investment by tax policy and a favorable business climate figures prominently in the plans of these governors, and most others. Added public investment is a less prominent theme partly because these states are running out of borrowing power and have conventional demands, such as school construction in California, for their remaining borrowing power.

FINANCING HEALTH CARE

Introduction

There appears to be widespread agreement that paying for health care is one of the most, if not the most, pressing national policy issues. Increasingly, state officials are saying that individual states cannot go it alone with comprehensive health financing plans that deviate massively from the coverage and taxes of competing states. So, there appears to be agreement that there is a major federal role in the solution, though disagreement about what that role might be. However, there is also agreement that the chances of any Congressional action before the 1992 elections are between slim and none. It follows that if anything is to be done this year, it will likely be done in individual states.

Possible State Action

While federal action can be deferred indefinitely, as it has been for decades, officials of every state will have to face tough specific issues in 1992 -- financing Medicaid if nothing else. Officials in nearly every state are also trying to find some way to act quickly to deal with uncompensated care, or at least the piece of it that appears most dramatically to them. There are plenty of choices for that piece: (1) poor, non-Medicaid, children lacking preventive care, (2) persons who can't buy coverage at any reasonable price, (3) services they think should be covered but aren't, such as substance abuse, mental health, or mammograms, (4) threatened or actual hospital closings in central cities and rural areas, and (5) employers and health care providers complaining about the costs of uncompensated care which they must absorb.

The Anatomy of Cost Increases

New federal cost projections confirm the worst fears about rising health care costs. Total national health spending is expected to reach $810 billion in 1992, $3,057 per capita. The growth rate is predicted to be about 9.5% per year in the early 1990s. This compares with population growth of just under 1% and growth in the economy of 6-7% (unadjusted for inflation). Medicaid is predicted to grow at 15.5% per year through the early 1990s.

Sources Of Hospital Cost Increases, 1990-1995

External Factors	
General Inflation	44%
Population	11
Health-Specific Factors	
Extra Health Inflation	19
Longer/More Stays	9
Real Service/Day	17
Total Cost Escalation	100%

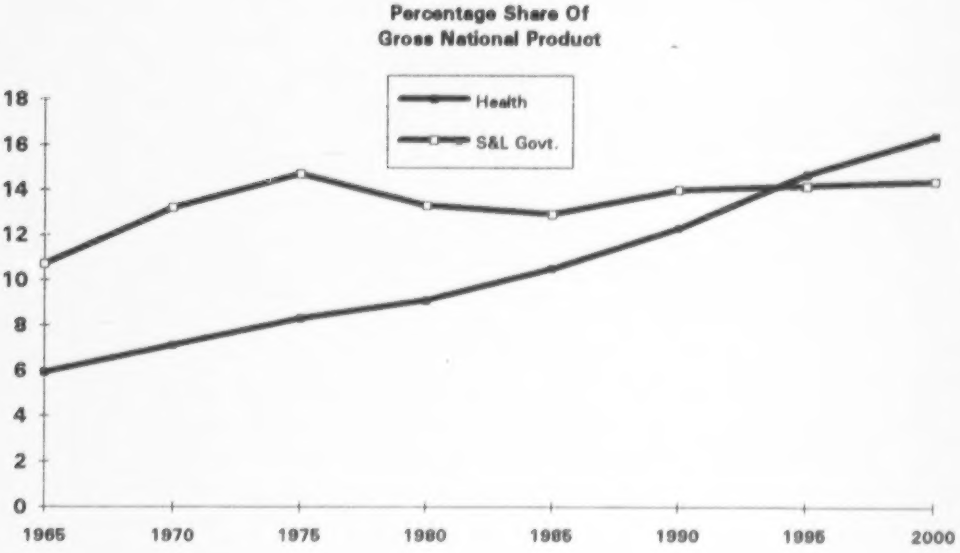
The projections are based on factors external to the health care system and factors within it. As shown at the left, over half the increase results from external factors -- price increases and population change, both the growth in population and its increasing average age. The rest of the increase is a result of people spending more time in the hospital, getting more intensive services while they are there, and the predicted continuation of price increases in health care that exceed price increases in the rest of the economy.

The federal projections suggest that governments will continue to pay an increasing share of the nation's health bill even without policy change. Government's share has risen from 25% in 1965 to 43% in 1991. It is expected to reach 47% by the year 2000. Most of the growth will be federal, as more and more people are covered by Medicare. The state and local (mostly state) share of the nation's bill is predicted to grow slowly from 13.3% in 1980 to 14.8% in 2000.

Health Costs Outpacing State And Local Government Costs

The rapid increases in health care costs make it inevitable that they will eventually exceed all the spending of state and local governments combined. This crossover point has just about been reached. The chart measures each as a percentage of gross national product.

State and local spending has been 13-15% of GNP since the 1970s. Because this spending tends to be more stable than the overall economy, the percentage is highest in recession years, like 1975, and lowest during rapid economic upturns. Health costs have been steadily rising as a share of national output. Many state officials have their own projections showing that, at the current rate of increase, Medicaid alone will start to use up all of the natural growth in state revenues.



Cutting Medicaid Services

Despite all the concerns about rapidly escalating Medicaid costs and the pressures on state finances, states generally *have not* been limiting the services provided under their Medicaid programs. The most costly services, such as in-patient hospital care and nursing home care, are mandatory under federal law. States have the meaningless option of dropping Medicaid entirely, but if they provide Medicaid they must include these services.

Cutting "optional services" is possible for some states, but others don't provide them or provide only a few. Part of the opposition to cutting them is simply the perception that they are more meritorious than whatever else might be on the chopping block. There is also the fear that eliminating Medicaid coverage won't eliminate the cost, just move it to another state or local program -- in the process switching from a 50-80% state and local share to a 100% state and local share.

Cuts are somewhat easier to make in Arkansas than in most states because of the state's long-established laws and traditions for adjusting spending to the amounts available. The budget is adopted in tiers with the first tier likely to be fundable regardless of revenue perturbations and the third representing "nice to have" spending that would only be made if revenues outran expectations by a wide margin. Within the middle ("B") tier, spending is adjusted administratively using a logic spelled out in the appropriations legislation.

In 1989, there were special restrictions such as those on the number of prescriptions. In July of 1991, the funding situation improved through bootstrap financing, which among other things permitted an increase in hospital rates. In December, cuts were announced to eliminate chiropractic services, physical therapy, private psychological care, and payments for certain equipment such as wheelchairs. There were new restrictions on the number of visits to doctors and hospitals and on available dental services.

The result was a well-publicized public protest in which 18 disabled people in wheelchairs chained themselves to the furniture in Governor Clinton's office. Some of the cuts were rescinded and a newly appointed task force is examining the issues.

The Uninsured

The statistics on Americans without health insurance coverage have been updated with discouraging results. Even counting Medicaid as insurance coverage and excluding all persons over-65 as having Medicare coverage, 35.7 million people lacked coverage in 1990. This represents an increase of 4% from 1989. From 1989 to 1990, 2.1 million *fewer* people had coverage from private health insurance but 3.1 million more were covered by Medicaid. The state statistics are shown below.

Percentage and Number (000) Of Non-Elderly Without Health Insurance, 1990

Rank	State	Percent	Number	Rank	State	Percent	Number	Rank	State	Percent	Number
1	New Mexico	26.4%	348	18	West Virginia	16.6%	258	34	Indiana	12.7%	604
2	Texas	24.1	3,618		**United States**	16.6	35,745	35	Kansas	12.6	273
3	Florida	22.9	2,445	19	Delaware	16.4	97	36	Pennsylvania	12.4	1,266
4	Mississippi	22.9	536	20	Montana	16.4	118	37	Ohio	12.1	1,151
5	Louisiana	22.5	804	21	North Carolina	16.2	892	38	New Jersey	11.9	800
6	Oklahoma	22.3	593	22	Maryland	16.0	661	39	New Hampshire	11.5	112
7	California	22.1	5,787	23	Tennessee	16.0	689	40	Massachusetts	11.1	559
8	Arkansas	21.1	436	24	Oregon	15.8	389	41	Vermont	11.1	55
9	Alabama	20.5	743	25	Kentucky	15.6	491	42	Michigan	11.0	895
10	Arizona	19.8	586	26	Missouri	14.6	680	43	Nebraska	10.3	142
11	Nevada	19.2	204	27	New York	14.4	2,250	44	Minnesota	10.2	394
12	South Carolina	18.9	564	28	Wyoming	14.4	60	45	Utah	10.2	160
13	Virginia	18.9	1,024	29	South Dakota	14.3	82	46	Iowa	9.8	233
14	Idaho	18.0	169	30	Rhode Island	13.9	111	47	Hawaii	9.2	82
15	Alaska	17.9	79	31	Washington	13.4	568	48	Wisconsin	8.6	350
16	Georgia	17.7	984	32	Illinois	13.2	1,352	49	Connecticut	8.5	238
17	Colorado	17.3	506	33	Maine	13.2	143	50	North Dakota	8.2	44

The highest percentages of those without health insurance are found in Southern states. They combine two determining characteristics: (1) a high percentage of low-income households and (2) a Medicaid program with strict eligibility standards.

Taxing Health Care Providers

In those states that were heavily involved in bootstrap financing, this will be the year to move to compliance with the new federal rules. The politics of the move won't be easy. For example, Alabama raised nearly half of its Medicaid match from providers. Ninety-five hospitals with 2% or more of patients covered by Medicaid paid a special tax while the 28 other hospitals didn't participate. Now Alabama must cover the match with the general fund, an unlikely alternative, or make the provider tax legal by broadening it to all hospitals. The old plan was sold because the participants would gain, but this won't be the case for those hospitals newly taxed. Those hospital officials are unhappy. The Alabama Hospital Association, which supported the earlier plan, will probably be neutral on this one.

Fighting It Out In Virginia

Question: *What can be done to deal with health care problems?*

Answer: *First of all you're going to have to make some people mad.*

This was the beginning of Governor Wilder's response on a C-SPAN interview (2/3) which centered heavily on his new campaign, which began almost immediately after he dropped out of the Presidential sweepstakes. The Dominion State developments are significant for other states as indicative of the consequences when elected officials and health care providers part company on how to pay for Medicaid. Virginia is providing a preview of how provider tax issues may develop in states where providers are opposing the tax.

The current estimate for Medicaid cost increases in the new (biennial) budget is $743 million, of which half would come from state funds. The budget proposes that a portion of this be covered by provider taxes. Physicians would pay $200 per year. Other providers would pay on a tax base of gross receipts minus receipts associated with indigent care. The rate would be 0.8% for hospitals, 1% for nursing homes, and 0.5% for pharmacists. Providers don't like the idea, preferring that the funds come from general revenue, supplemented as necessary by higher taxes on alcohol and tobacco.

Freed from the constraints of a Presidential campaign by his decision to drop out, Governor Wilder is attacking provider opposition head on and publicly. At a hearing in January, he suggested overspending in health care, such as "the posh salons and furnishings that have turned some hospital units into resorts." He was critical of prices in hospital bills of common items (e.g., $5 for aspirin and $300 rent for a walker that can be purchased for $50) that exceed market prices. He also attacked "slick advertising," not-for-profit hospitals that make profits, and industry use of "high-priced lobbyists, scare tactics and catchy slogans."

He suggested providers could absorb the tax without increasing prices, even urging that passing along the tax to consumers be made a crime. He endorsed new regulatory activity including controlling hospital rates, executive salaries in the health care industry, and overcharges for drugs and supplies. He suggested reviving certificate of need procedures requiring state approval of major capital outlays such as CAT scan equipment.

The new levies like Virginia's probably won't be called taxes by those proposing them and probably won't even be called revenue enhancers. Virginia's is "Shared-Provider Financial Participation."

Covering The Uninsured In Pennsylvania

Pennsylvania may be the exception to timidity among state officials in adopting potentially expensive new coverages in health care. Governor Casey has proposed a state-run, state-paid program to cover children in families too affluent to qualify for Medicaid and not "well off enough to pay for insurance of their own." This test will equate to about $40,000 in family annual income. Coverage would be available for every child in such families not covered by private insurance or Medicaid. As outlined, it would appear to cover all costs (e.g., medical, dental, drugs) without deductibles or copayments, but exclude the high end of costs, particularly hospitalization beyond 90 days. Opposition immediately appeared from those concerned that the state shouldn't be trying new initiatives while the governor is making administrative cuts in current ones and warning of possible fiscal problems.

The Outlook For State Action

It would be surprising if any state adopts comprehensive health care financing legislation in 1992. To be comprehensive such plans must do something about a state's share of the 36 million or so uninsured citizens. Substantial new state money for this coverage is part of the plans that are most acceptable to health care providers and private employers. But the states don't have that kind of money and aren't likely to try to raise it in 1992. Another choice is to make employers cover their own employees ("play"), or reimburse the state for covering them ("or pay"), plus help cover the unemployed uninsured and those employed by exempted small business employers. This choice is unacceptable to many employers not providing coverage and to some employers who do. The other enticing possibility is to pay for new coverage by "savings" from administration, utilization controls, and limits on how much providers are paid. That alternative is hard to package in a form acceptable to providers.

In simple terms, legislators are being given the election-year choice of: (1) doing nothing while agreeing that something should be done, (2) going to war with taxpayers, (2) going to war with employers, or (3) going to war with providers. The answer has consistently been coming up #1.

North Carolina's situation was recently assessed by the N.C. Center for Policy Research which concluded, "the best thing to do may be to encourage the states to experiment." There is a legislative study commission examining the subject, but it is not scheduled to report until 1993. Study commissions to report in time for action 1993 or later also represent the solution of choice for Iowa and will be for Colorado if the governor's recommendations are followed.

In a recent address to the Georgia legislature, Governor Miller conceded that making health care more affordable wasn't a major part of his agenda. Instead, he said the issue "largely must be addressed at the national level."

FISCAL CONDITIONS UPDATE

Though releases of bad news are common, **state fiscal conditions are even worse than they appear to be.**

The surveys released in January by the state budget officers and the National Conference of State Legislatures were filled with bad news -- more than half the states running current deficits, spending cutbacks, and poor outlooks for FY 1993. Since those estimates, many of which were made in November and December, revenue performance has been lackluster and more spending overruns have developed. These developments are understood in individual states, but not as a national phenomenon.

Major states, particularly **California** and **New York**, have not yet taken actions to deal with the deficits their governors announced in December. As California's Director of Finance put it, "the longer we wait, the larger the problem becomes." The bad news for the current year cascades into the FY 1993 budgets in the form of lower incoming balances (or higher incoming deficits), lower revenues as projected growth rates are applied to a lower base, and higher spending as projected growth rates are applied to a higher base.

California has the largest numbers, but its problems are found in many states. In early January, the governor proposed his $60 billion budget which was balanced without new taxes, but with many proposed spending cuts and tenuous reserves. In late January, the Commission on State Finance said the budget was out of balance by as much as $2.6 billion and, in a worst case scenario, by as much as $6 billion. The Finance Director conceded the problem:

> *The economic forecast which was used to prepare the budget was conservative relative to most private sector economists. But it now appears that actual economic conditions are worse than we projected.*

The governor reiterated his opposition to tax increases on top of the $7 billion in revenue increases last year. Instead he said, "We are probably going to have deeper cuts." This is still the response to worsening fiscal circumstances in all but a few states.

There is bad fiscal news even in states that recently raised taxes. **New Jersey**'s budget is tight for all the same reasons as other state's, plus the decision to earmark essentially all the new money from the large 1990 tax increase -- leaving tight situations in funding universities, Medicaid, and state operations.

Kentucky's massive 1990 tax increase was earmarked for education reform, but generated substantial surpluses because the tax increases took effect before the spending increases. By spending down the resulting surpluses in the current biennium, legislators left a big hole to fill in the biennium beginning in July. The recession dug the hole deeper by an estimated $60 million in FY 1991 and $170 million this year. With their statewide elections last November, state officials pushed many of their problems into the new budget to be considered this year. Now they must cope with scheduled increases in debt service, promised increases in school aid, and apparently inevitable increases in corrections and Medicaid. In his state-of-the-commonwealth address, newly inaugurated Governor Jones said, "Never before in our modern history have we faced a financial challenge of the magnitude of the one now before us."

Two of the largest 1991 tax increases were in **Connecticut** and **Pennsylvania**. Governors of both states have announced tight budgets for FY 1993. Pennsylvania is holding back spending administratively this year. Connecticut officials are looking at massive cuts in general assistance and cost-saving revisions in aid to local government.

Taking quick action to solve the problem doesn't seem to be solving the problem. **Florida**, **Georgia**, and **Illinois** legislatures acted this winter to rebalance their FY 1992 budgets. Shortly thereafter, new projections indicated that new budget gaps had opened.

In many states, nothing is happening and little is being said. Legislators and governors are waiting until closer to the beginning of the fiscal year to reassess their positions in light of whatever the economic outlook then appears to be.

TAX CUTS FOR BUSINESS

> *If we don't expand the job tax credit, South Carolina, with all its tax credits, will eat our lunch. We are in conversation with one of the major, major poultry processors in this country. One state is offering them a job tax credit, and we aren't in the county they are looking at. But this bill would change that.*

This was part of the pitch Governor Miller offered the Georgia Chamber of Commerce in seeking support for his new business tax credit proposal. The credit would be $2,000 per job in the state's poorest counties, $1,000 a job in the 40 next poorest, and nothing in the rest. The proposal typifies the many business tax reductions being adopted in the name of economic development even in tight state fiscal conditions.

Polls indicate that jobs and the economy are of paramount importance to voters. Logic and experience indicate that jobs and the economy are critical to healthy growth in state and local revenues. So elected officials want to stimulate jobs -- more private sector jobs, not a larger public payroll. Direct grants to business often aren't attractive to firms or state officials because of possibilities for favoritism and manipulation, increasing on-the-books spending, and potential public opposition. By the process of elimination, business tax reductions to stimulate development emerge as an attractive policy.

The Massachusetts Cuts

Governor Weld's supply-side tax cut proposals include substantial business tax relief. Business would get, though only for one year, strong state tax incentives for creating new jobs. A new tax credit would offset up to 90% of the tax liability associated with new jobs and a possible additional 10% for employers providing job training and child care. In addition, there would be a "bonus tax credit" for investments in new plant and equipment. Along with the business tax cuts, the proposed cuts in personal income tax rates and capital gains (including basing the tax on the holding period) were offered as helping to improve the business climate.

If the legislature adopts these recommendations, Massachusetts could be the only state in the nation to make major tax cuts this year. If the Bay State can afford such cuts, then just about every other state can also. While there are signs that the state's downturn is bottoming out, its economy fell farther from previous levels than nearly any other state. Bond ratings remain the nation's lowest. A recent article in State Budget & Tax News (Issue 5) outlines a possible scenario of more fiscal troubles if the state yields simultaneously to forces for cutting taxes and raising spending.

As presented by the governor, the tax cuts would use about a third of the increases in revenue expected in FY 1993. From this perspective, they are paid for by revenue growth, not cuts in education or social programs. But major activities -- higher education, social services, and general aid to local government -- are budgeted for lower amounts than necessary to continue current services. From this perspective, critics see the plan as cutting into social services to make life easier for business.

Business Tax Reduction In Other States

Governor Castle has proposed that **Delaware**'s $250-per-job credit for hiring new employees be doubled – tripled for firms that provide health care benefits. He also proposes to give individuals a tax credit of $15 for each $100 they invest in small businesses in four targeted industries. With new downward revisions in revenue estimates, the legislature will be trying to balance the budget with essentially no revenue growth in FY 1993. The governor contends the business tax reductions would pay for themselves with added revenues.

In **New Hampshire**, Governor Gregg wants to abandon the state's traditional resistance to aiding particular firms, which he calls *laissez faire*. In its place, he wants tax concessions targeted to firms willing to locate at a major air force base that is being closed. He would pay for these and other development ideas by business taxes, such as repealing an existing credit for job expansion or a new franchise fee.

In **Ohio,** Governor Voinovich proposed "no increase in major state taxes," but some "revenue enhancements" while suggesting that the state "look seriously" at a sales tax exemption for machinery and equipment purchased for research and development. In Pennsylvania, the Republican-controlled Senate has passed business tax cuts, including reducing the corporate income tax rate. While these aren't likely to succeed in the Democratic-controlled House, they are indicative of serious interest in business cuts.

Louisiana, like many states, routinely offered property tax exemptions for new investments in plant and equipment. Then-Governor Roemer, in a move that gained nationwide publicity as innovative, began conditioning the availability of tax exemptions on characteristics of individual businesses, such as how much pollution they caused.

Industry opposed the move as discriminatory against the Louisiana industrial base (e.g., petrochemicals) and reducing the likelihood of investment in Louisiana rather than other states which didn't follow the state's lead. Governor Edwards criticized the plan during his campaign and announced in January that the state will discontinue it.

Business Winning By Not Losing

If the objective of business is to lower the percentage of state and local taxes paid by business, tax cuts need not be a part of the strategy. The objective can be achieved if increasing state costs are covered by tax increases on individuals rather than business. Even larger reductions in business percentages occur if a tax increase on individuals relieves a tax on business, as when sales taxes on consumer goods and services are raised to relieve pressures on local property taxes. From this perspective, the lack of interest in business tax increases may be more significant than the interest in business tax reductions.

The recent National Conference of State Legislature's survey of legislative leaders (Leaders' Outlook) includes an assessment of the "relative likelihood of certain tax increases" this year. The greatest interest is in selective excise taxes like those on alcohol and tobacco, which NCSL sets at an index number of 100. In descending order, the less likely forms of state tax increases are expansion of the sales tax base (87), closing income tax "loopholes" (54), raising the sales tax rate (43), and raising the income tax rate (35). Raising business taxes (34) was the least probable of the increases considered.

Spending To Stimulate Business Location And Expansion

There are also spending proposals to encourage job creation. In **Delaware**, the governor wants a new fund for pay relocation costs of companies moving to the state as well as expansion of loan and training programs designed to help small businesses expand.

Many states are considering packages oriented to individual business decisions such as a new McDonnell Douglas plant, a maintenance facility for United Airlines, and many smaller facilities. Because General Motors has announced it is considering closing a plant in **Michigan** *or* one in **Texas**, state officials are competing with concessions to keep their plant open. These are but large examples of many situations involving fewer jobs, fewer competing states, and less publicity. New tax concessions, sometimes broader than the single plant-location decision motivating them, are being discussed in many of these cases.

In **Connecticut**, the governor's budget has more than a billion dollars in cuts to avoid another tax increase. But the budget includes $35 million to fund state financial aid to companies and legislation adopted in 1990 to assist manufacturers by giving local tax exemptions (with state reimbursement of lost revenue). His plan would also eliminate a surcharge on the corporate income tax, provide for reduced business property taxes in central cities, and enact tax exemptions for computer equipment, aviation fuel, and aircraft repairs.

INVESTING PENSION FUND ASSETS

Introduction

The **California** state and local employee pension plan (CalPers) announced in January that it was investing $225 million in loans to home builders to finance construction. In the announcement, the program was touted as offering: above-market rates of return (14-22%) and stimulation of the California economy by assisting in revival of the depressed housing construction industry. In the words of the controller, the plan provides "a happy coincidence of above-market returns and a strong economic stimulant." The announcement illustrates continuing issues in pension fund investment policy.

Social Investing

As pension fund assets build, controversy continues over whether any part of them should be invested for policy-related purposes such as stimulating the economy of a state, making loans to members of the pension system, or bailing out stressed local governments. Proponents of these policies often look to pension funds for money that can't be obtained other ways. Pension fund trustees typically contend that assets should be invested solely for the benefit of potential retirees, so lower returns and greater risk should be avoided.

As might be expected, instances of social investing have produced mixed results. The most notable losses have been in housing investments in **Alaska** and in development-oriented business investments in **Kansas**. Some of the successes include loaning money to New York City in the 1970s and home mortgage loans in **Hawaii**.

Pension officials risk adverse publicity regardless of the decisions they make on in-state investments. The **Kansas** investments have become a major scandal. **Michigan** has no such scandals, but pension investment policy was the subject of a major critical investigative report by the Detroit News (1/12). Pension managers are accused of neglecting Michigan, particularly Detroit, while investing in real estate in Honolulu. The state has more apartment investments in Las Vegas than Detroit, more real estate money in Sacramento than Lansing, and more big real estate deals in Texas than Michigan. Michigan is the primary owner of the Texaco Heritage Plaza in Houston where 3,500 people -- "many resettled from the Rust Belt states" -- now work.

Looking For Safe Social Investments

A common practice is finding investments that appear to offer both market rates of return given the risk *and* the appearance of stimulating the local economy. Examples: (1) purchase of publicly traded stock of companies with operations in a state and (2) purchase of portfolios of loans secured by in-state home mortgages.

California's Treasurer recently announced a plan to purchase loans on California homes guaranteed by the Federal National Mortgage Association and to purchase loans previously made to California small businesses guaranteed by the Small Business Administration. She has legislation pending to purchase farm export loans guaranteed by the Commodity Credit Corporation. Her announcement of the new purchases epitomizes the "best of both worlds" approach:

> *These investment strategies will produce safe, prudent, and attractive returns for California. And, just as important, they will help fill financial voids that have hurt home buyers, farmers, and small businesses.*

The **Massachusetts** Treasurer recently announced a similar, but more complex, program of investing in small business loans originally made by banks that have failed. The portfolio will have back up guarantees from successors of the original lenders and the Small Business Administration. **Pennsylvania**'s treasurer has a plan that provides financing for the period before new homeowners assume ownership under an arrangement of the Pennsylvania Housing Finance Agency that amounts to lease-purchase. Part of Governor Casey's proposals for job creation include putting a larger portion of pension fund investments in Pennsylvania.

Because there is no agreed definition of social investing, there are no reliable statistics on how much is being done or how successful it has been.

Risk And Return In Pension Investing

State plans on average are more risk-averse than private plans, investing a lower portion of portfolios in stocks and a larger portion in U.S. government bonds and notes. The investment strategies of state pension plans vary considerably in their tolerance for risk. Some, like CalPers, have long included significant components of risky investments that promise high returns, but as part of a balanced portfolio strategy that includes some lower yielding more secure investments. Some states avoid certain types of risky investments (e.g., small company stocks, low-rated bonds) entirely.

Investing in construction loans to developers is traditionally a high-risk, high-return business compared with loans to homeowners. Construction loans that went sour have much to do with the demise of many banks and S&Ls. This will deter pension managers in most states from following the California lead.

Risk, Return, And State Budgets

In the last several years, many states have used pension plans as a way to help balance budgets. The investment earnings of the plans, such as 8-19% on bonds and 12-20% on stocks, were far in excess of the returns of 5-8% assumed in actuarial calculations. State officials took advantage of this situation by lowering the percentage of payroll contributed to the plans and, in some cases, deferring the employer contribution. These actions were a major part of California's budget balancing last year and have helped New York for several years.

Under current conditions, this strategy appears much more risky. Pension plan investment assumptions have been increased, generally to the 7-9% range. Investment yields have declined to under 8% for federal long-term bonds, slightly more for corporate bonds, under 6% for short-term federal securities, about 3% for stock dividends, and, as usual, an unknown amount for stock appreciation.

TECHNICAL NOTES

Entrepreneurial Government: Generally accepted economic concepts underlie Reinventing Government, but there are lapses in applying them. In discussing "command-and-control" regulation of pollution, the authors are sensitive to costs government imposes on the private sector. In other discussions, such as saving fire department costs by requiring sprinklers, they aren't sensitive to total costs. They don't use "opportunity costs," so discussions like one lauding a city for buying a theme park are incomplete.

Many of the book's generalizations beg for elaboration. For example, private fire companies are lauded for encouraging fire prevention but private garbage companies are criticized for resisting efforts to reduce garbage generation. Because universal health coverage without rationing will increase costs, Osborne's *management* recommendations on health care are also *resource allocation* recommendations requiring that more money go to health and therefore less to private consumption and/or other public spending. Whether this is desirable is more than a management question.

Linking budgets and performance measures is an old idea, reflected in program budgeting systems used in many states. Asking whether something is worth doing at all before talking about how much to spend is the concept of zero-based budgeting. The alternative is a non-zero base like last year's budget or last year's with more or less money. Everyone would agree that state officials should periodically ask whether to have parks. Nearly everyone would agree they don't need to remake that decision each year, but do need to consider incremental changes in park budgets relative to competing uses of funds.

Governor Carter adopted zero-base budgeting in Georgia. By the time his consultants published their book, the Georgia base wasn't zero but 5-10% less than last year. Osborne's book calls zero-base "too cumbersome" but says Phoenix has "a successful modification" -- looking at 10% cuts (a 90% base). Governor Weld is touting zero-base budgeting, looking at whether programs are worth continuing, a true zero-base.

Health Care: Health cost projections are from the Health Care Financing Administration (Health Care Financing Review, (Fall 1991). State and local percentages of GNP come from ACIR's Significant Features Of Fiscal Federalism. **Reports** projected 14.2% for 1995 and 14.5% for 2000. The N.C. Center (P.O. Box 430, Raleigh, NC 27602) study of health options appears in the its North Carolina Insight (November 1991).

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* Indicates title of an article

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STATE POLICY REPORTS

VOLUME 10 ISSUE 5

IN THIS ISSUE

Decisions are being made on six state issues which could have major impacts far beyond those states where the issue is hot. The six possible turning points are: cutting government in Massachusetts, welfare reform in New Jersey, sick taxes in Virginia, business taxes in Florida, Medicaid reform in Oregon, and financing schools in Texas.

- Six Critical Decisions p. 2
- Retrenchment p. 3
- Balanced Welfare Reform p. 4
- Health Provider Taxes p. 6
- Unconventional Business Taxes p. 6
- Rationing Health Care p. 7
- Financing Schools p. 8

Officials in many states, such as California and Illinois, are having extreme difficulty making budget decisions this year. The reasons have nationwide implications.

- Fiscal Strategies p. 9

Major reforms in health care financing are producing no action but a blizzard of paper at state and federal levels -- plans, studies, proposals, bills, and detailed criticisms of each. Medicaid costs spiral with cost-cutting often failing, while cost-increasing efforts work.

- Health Financing Update p. 12

With state spending stagnant, university administrators are telling legislators they will cut quality or serve fewer students, maybe both.

- Higher Education Strategy p. 17

New York could be the first state to enter FY 1993 without an approved budget. Many states could end FY 1992 in deficit -- causing a reexamination of what balanced budget requirements really mean.

- Resolving New York's Finances p. 20
- Balanced Budgets And Revenue Estimating p. 24

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March 1992 (First Of Two March Issues)

SIX CRITICAL DECISIONS

Important And "Hot," But Routine, State Issues

In Issue 3, **Reports** drew on state-of-the-state messages, surveys of legislators, and other sources to summarize major state issues in 1992. Many of these issues are well understood, new alternatives aren't being offered, and the arguments for and against policies haven't changed. Examples are capital punishment, how much to rely on tuition to finance higher education, and how much to pay state employees and teachers. While there is value in monitoring these issues in 50 states, decisions on them in one state don't make decisions in another state much easier.

Significant Turning Points

This article takes a different look, attempting to select the states and issues where developments in one state may well spread to others. Proposition 13 in California was one such issue. After California voters approved it, its property-tax-limiting features were debated in nearly every state, and adopted in many. The California action wasn't significant because imposing a property tax limit was a new idea, nor because California drafters invented a better way to implement it. The impact arose because of an essentially political demonstration that strict property tax limits were an idea whose time had apparently come.

The six issues, representing possible turning points in state policy -- six situations worth watching -- are shown below.

Critical Issues And Battlegrounds, 1992

Issue	Primary Battleground	Other Battlegrounds
Retrenchment	Massachusetts	Michigan
Balanced Welfare Reform	New Jersey	Vermont
Health Provider Taxes	Virginia	Iowa, Oklahoma
Unconventional Business Taxes	Florida	Nevada, New Hampshire, Washington
Rationing Health Care	Oregon	Colorado
Financing Schools	Texas	Kansas, Oregon, Tennessee

Not every observer would necessarily pick the same six issues. But **Reports** has some advantages over other observers -- a multi-state perspective, no dues-paying members and thus no internal politics to affect selections, and readers who tolerate complex treatments of complex choices rather than good guys, bad guys journalistic over-simplifications. The selections omit many issues that some readers (and perhaps the editors) believe *should be* on the list but don't appear because major decisions about them don't seem to be in the cards this year. Examples: school choice and a new round of education reform, tax reform, universal health care plans, and privatization.

RETRENCHMENT

Usual Responses To Tight Times -- Raise Taxes, Cut Programs

Recession-retarded revenue growth, inflation, federal mandates, growing caseloads in income-tested programs in practically all states, and growing school enrollments in many sates combine to dictate the curtailment of current state services or tax increases in most states. Some states will respond by significant tax increases. Some will respond by borrowing, selling assets, or other financial maneuvers that put off long-term budget-balancing decisions. Some will respond with service cuts.

Unusual Responses To Tight Times In Massachusetts -- Cut Taxes, Cut Programs

Almost none of the states -- when all is said and done, maybe none -- will respond to the situation by cutting taxes. This is why Governor Weld's tax-cutting proposals in **Massachusetts** (described in Issue 4) have drawn so much interest. Massachusetts is already on its tax-cutting course. The sales tax on services was repealed last year. The income tax rate was lowered in January. The next action will be on the new tax reduction proposals and the FY 1993 budget, both scheduled for decision before July.

Even if the governor's proposals are adopted, the retrenchment policy will not be fully tested until at least 1993. Massachusetts in 1991-1992 parallels the federal situation in 1981, when President Reagan took office. Democratic majorities in the legislative bodies haven't bucked the chief executive on tax cutting issues. But they are reluctant to adopt recommended spending cuts. Some outside observers believe that even if enacted exactly as proposed, Governor Weld's package would produce a deficit, parallel to the federal one produced in the "bidding war" to cut federal taxes. The difference lies in the state's inability to match the federal government's capacity to run large deficits indefinitely.

Unusual Responses To Tight Times In Other States

Cutting taxes and thereby restraining spending has enormous appeal, even when state and local budgets are clearly tight. Majorities in the **New Jersey** legislature are determined to lower the sales tax rate by one cent. **Pennsylvania**'s governor has recommended that the "temporary" income tax increase adopted last year expire on schedule this summer. Governor Symington's tax cut recommendation in **Arizona** is also an example, but the state's chaos level (e.g., governor fighting criminal charges, legislature facing backlash on its ethics) and unique problems (e.g., its non-Medicaid indigent health financing arrangement) make the state an imperfect model for other states. Because voters rejected the tax measures put on the November ballot by the governor and legislature, some temporary taxes are expiring in **Missouri** this year.

Attempts to limit local property taxes are common in many states, particularly in the West where in some states they appear nearly every year. Although old news, the limit approved by **Oregon** voters will start to have its major bite this year. After spending the better part of a year feeling voters' pulses, Oregon's governor says she will not be pushing for compensating higher state taxes this year. As a result, to comply with the mandate that the state fund local losses, state spending on other activities may be curtailed sharply. Officials in other states, particularly **Colorado** and **Idaho**, are considering their fiscal choices this year with one eye on the repercussions for passage of similar voter initiatives in their states.

The runner-up to the Bay State as an example of possible retrenchment is **Michigan**, which differs primarily because the governor's pressure is on local property taxes, not state taxes. Governor Engler's budget is tighter than Governor Weld's in some areas, particularly elementary and secondary education.

BALANCED WELFARE REFORM

Typical Debates Over Welfare

Welfare dependency is a social, fiscal, political, and law enforcement problem that won't quit. The predominant form of state welfare debate is a bitter, usually partisan exchange. Both sides condemn welfare dependency. One side concludes that payments should be lower or at least not raised, eligibility should be tightened or at least not increased, and that recipients should be required to do something more such as taking jobs, going to school, keeping children in school, and/or paying their landlords. The other side accuses the first of being heartless and lacking compassion, failing to recognize the needs of the poor, and shortchanging innocent children. The case is argued everywhere, with articulate debates between the governor and legislative leaders in **Wisconsin** a good example.

Pressures For Compromise In California

As Governor Wilson (R) takes his welfare-cutting initiative to the public, **California**'s debate will gain more national attention than it already has. Before the voters see the benefit-cutting initiative on the November ballot, the legislature will have to act on welfare in the context of the FY 1993 budget. Legislative leaders (D) are clearly worried. House Speaker Willie Brown recently told the press that "fear of voter punishment as a result of trying to defend the so-called welfare system" concerns everyone in his party's caucus. His policy assessment is:

> *We have got to try to separate out the part of the welfare system that drives us all mad, and take care of the part that is really appropriate and reflective of good human concerns for each other.*

To the dismay of some California advocates for the poor, Brown indicated that House Democrats would likely support many features of proposed welfare reforms including: (1) lower benefits for new California residents, (2) limits on benefits for able-bodied adults who won't take available jobs that pay decent wages, (3) public service work requirements for those who don't find private sector work, and (4) continuing income-tested benefits like Medicaid and child care for former recipients who take jobs and otherwise would lose eligibility.

Failures Of Past Compromises

Legislators in California and elsewhere would love to find an affordable solution that could command bipartisan support. This is what they though they had in the late 1980s, when some states experimented with programs to put welfare recipients to work with apparent success. The governors of both parties sold a reasonably enthusiastic Congress on welfare reform measures built upon programs like California's GAIN and Massachusetts' ET. Success has been elusive. Dramatic gains in employment of welfare recipients haven't occurred. Welfare rolls have increased. States have been reluctant to undertake the programs now required of all of them by the federal legislation. GAIN, ET, and their clones are being cut back by the states that pioneered them. Some states are not using all the federal matching money available for these programs.

New Legislation in New Jersey

In this context, **New Jersey**'s welfare reform measure (Issue 3) signed by the governor in January is amazing politically, if not substantively. The lame duck session passed it by wide bipartisan margins in a legislative session so partisan that one party was trying to prevent action on anything by refusing to show up (thereby avoiding quorums) and the other party was trying to repeal taxes everyone agreed were necessary to maintain a balanced budget. The measure recognized both some actions previously viewed as punitive (e.g., not increasing monthly checks for children born while a recipient is on welfare) and some previously viewed as too liberal (e.g., not requiring a new stepparent to assume full financial responsibility for children already in the household).

If the necessary federal waivers are approved, the New Jersey legislation will be in effect in July. In other states, legislators will pick and choose among the punitive and liberal aspects, many of which were already on their agendas. Whether any other state will be able to adopt such sweeping change remains to be seen. Of course, everyone will want to know whether the changes work, but hard evidence on that won't start to be available until 1993.

HEALTH PROVIDER TAXES

There are many ways to make one health consumer pay for another consumer's care, which is basically what country doctors did when they treated some patients for nothing, some for chickens, some for whatever they could pay, and some for the going rate. With specialization among health care providers and competition among third-party payors, more formal mechanisms have been required to maintain these cross-subsidies.

These can be established without money flowing through state general funds, as **New Jersey**, among other states, has done with an uncompensated care fund financed by what amounts to a 20% gross receipts tax on hospitals. To pick up the federal matching money through Medicaid, states must collect this money, though some states have been keeping the action out of their general funds by establishing special funds.

With the donations programs ruled out by new federal rules, the money must come from all providers (or all taxpayers), which inherently includes some that will contribute more to such funds than the benefits they receive. **Virginia**'s situation (Issue 4) is important because it will show what happens when some of the providers decide to fight these taxes. Politically, it will be a lesson for elected officials on the costs of proposing them and a lesson for providers on the costs of opposing them.

Oklahoma legislators are discussing taking the issue to the voters, which could lead to an interesting campaign. This unusual, and constitutionally unnecessary, step is a serious choice because of strong opposition to a tax increase several years ago. The expectation was that if passed as a regular measure, its provisions would be suspended by voter referral procedures. The measure was held in the legislature until a two-thirds vote could be obtained so it could go into effect immediately. It did, but it then went to voters in the stronger position of an existing tax, not a proposed tax, and was narrowly approved. Now an initiative is being pushed to require all tax increases to go to the voters. Legislative enactment of a "sick tax" would presumably give the initiative's proponents more ammunition.

UNCONVENTIONAL BUSINESS TAXES

While it has few advocates among elected officials, state or federal, or among business leaders, the value added tax keeps appearing in discussions of tax policy. It has serious state-level advocates like Gerald Miller, who served as the executive director of the state budget officers in the 1980s. The VAT keeps cropping up in state tax study reports. Michigan has used the concept for decades, with no sign of change. It appears frequently in tax policy discussions in other states such as **Louisiana**, **Nevada**, and **New Hampshire**. This year it is part of the governor's program in **Florida**.

Don't count the value added tax concept as being dead. The widely used argument for universal health insurance -- only the U.S. and one other major country don't have it -- is an argument for VAT also. The former states of the USSR are adopting theirs now. The argument against current health policy -- there are hundreds of dollars more in health costs in an American car's price than in a Japanese one -- is an argument for substituting VAT for the corporate income tax. Under the General Agreement on Trade and Tariffs, nations can rebate the VAT component of goods sold for export, but cannot rebate the portion of costs attributable to national and state taxes on corporate income.

VAT also responds to the concern that economic activity escapes taxation because it is carried out by proprietorships, partnerships, corporations not organized to make a profit, and for-profit corporations in unprofitable years. This is a particularly vexing problem in states like **Nevada**, **New Hampshire**, and **Texas** that don't tax individual income. Owners can raise their salaries to convert taxable profits to untaxed income.

The immediate prospects for the tax in **Florida** are limited. Many legislators don't want to raise taxes at all. Those that do are more interested in tax changes to help finance the new FY 1993 budget than the governor's VAT proposal which wouldn't have significant revenue effects until FY 1994.

RATIONING HEALTH CARE

The standard methods for trying to cut Medicaid costs fall into simple categories: (1) reducing the number of people eligible, (2) cutting reimbursement rates paid providers, and (3) somehow becoming more efficient, such as by using managed care. Cutting services to an eligible recipient is a limited alternative under current law. States now providing optional services (e.g., podiatry) can drop them and limits on extreme utilization (e.g., limits on physician visits per month often considered in New York) can be adopted.

The **Oregon** experiment has received widespread publicity because it offers a potentially better idea, setting priorities among services to be covered. It has drawn considerable interest in other states, but no action. At the moment, there is no Oregon Plan for other states to copy. Oregon needs a controversial federal waiver. If this is achieved, Oregon can implement its plan, though the legislature will have at least one more opportunity to decide not to do so.

While explicit rationing has been considered in other states, such as **Colorado**, the idea now appears to be on hold. Implementation in other states wouldn't offer immediate budget relief because they would presumably opt for a long consultation process like Oregon's. Whether a federal waiver would be granted is unknown, at least until there is action on Oregon's plan.

FINANCING SCHOOLS

Two constraints prevent **Texas** from having school finance equalization systems resembling those in the states -- like **California**, **Kentucky**, and **New Mexico** -- that have nearly full equalization. First, it has no personal income tax and its voters don't seem to want one. Second, it has a constitutional prohibition against a statewide property tax.

When the state supreme court required equalization the first time, the state raised the sales tax to pump new state money into poor districts. When the court threw that out as not enough, the state responded by increasing the sales and other taxes and creating fiscal districts to collect a county education tax. The new levy was designed to have the economic impact of a statewide property tax but not to be one in the eyes of the law.

NO said the richer school districts -- if it's designed to have the effects of a statewide property tax then it is one. In late January by a 7-2 margin, the state supreme court agreed that the new arrangement violates the state constitution. BUT, the justices (many up for election in November) said, legislators (also up in November) could treat the tax as constitutional until the summer of 1993, but no longer. The aspect of the decision permitting additional collections of an unconstitutional tax is under collateral attack in federal courts. (See State Budget & Tax News, 2/12 for more detail.)

Considerable brainpower will now go into designing something that: (1) provides equalization, (2) doesn't result in a statewide property tax, and (3) doesn't take so much state money that it requires a state income tax or equally awful alternatives like double-digit sales taxes. Such a plan could conceivably be developed, but the result would be difficult to explain, even more difficult to sell to legislators and the public, unpalatable to taxpayers in rich districts, and again subject to litigation. Another possibility, which hasn't received much attention, is to alter the state constitution to give the legislature, not the courts, clear authority to decide what equalization means. Texas officials and experts are now debating alternatives, with a special session of the legislature possible. They have what would be considered a dream question in a classroom. If you had to design a state-local tax system from scratch, what would you do? How much sales tax? What split of revenue between state and local government governments? How large would school districts be?

Haven't I Heard That Somewhere Before?

The state-of-the-state and budget messages often have more than one governor claiming to be first in the nation in something. Example: Governor Bayh told the Indiana legislature about the FY 1992 budget, "the final result -- no tax increases, more money for education, and a healthy surplus -- makes Indiana the envy of other states." Not the envy of Michigan whose governor said, "As a result, Michigan became the only state in America to significantly reduce a massive budget deficit, increase funding for education, and hold the line on taxes."

FISCAL STRATEGIES

Traditional Budget And Tax Battles

Some elected officials want lower taxes and less government and some want higher taxes and more services. During a legislative session, these forces bang on each other, mobilize public support, search for majorities, and conclude with a budget. This classic fiscal drama is being played this year in states like **California**, **Florida**, **Maryland**, **Mississippi**, and **New York**. Most years, there are good shows in **Minnesota** and **Wisconsin**, but their officials are taking a mid-biennium break.

Oversimplifying, the players can be thought of in three groups: (1) **the shrinkers**, known pejoratively as "Neanderthals," who want the state's role and tax burdens reduced, (2) **the fiscal managers**, who aren't looking for major changes in the state role, and (3) **the expanders,** known pejoratively as the "tax-and-spend crowd," who want to do more and better in education, infrastructure and/or social services. Pure cases of expanders and shrinkers aren't often found in leadership positions. They tend to be held by those subscribing to the prevailing public view that services should be expanded *and* taxes reduced. The pure cases will be found among the backbenchers ~~of~~ nearly every legislature.

Real World Fiscal Strategies

It takes immense pressure to make major changes in state spending and taxes. So the big battles over fiscal issues come at crisis periods when there is a mismatch of spending and revenues too large to be ignored. Business cycles interact with state finances to produce these crises often, including now in most states. Savvy shrinkers, expanders, and fiscal managers have different strategies for the stages of the cycle as shown below.

Budget Strategies For Expanding, Shrinking, Or Maintaining State Financial Roles

Economic/ Budget Situation	Budget And Tax Strategy For: Shrinking	Expanding	Maintaining
Normal Growth/	Spend Income, Seek Tax Cuts	Spend Income, Seek Tax Hikes	Spend Income No Tax Changes
Rapid Growth/ Budget Surplus	Spend Below Income Cut Taxes	Spend Income No Tax Changes	Spend Below Income Build Reserves, Rainy Day Funds No Tax Changes
Recession/ Budget Deficit	Spend Income No Tax Changes	Spend Above Income Increase Taxes	Spend Above Income No Tax Changes

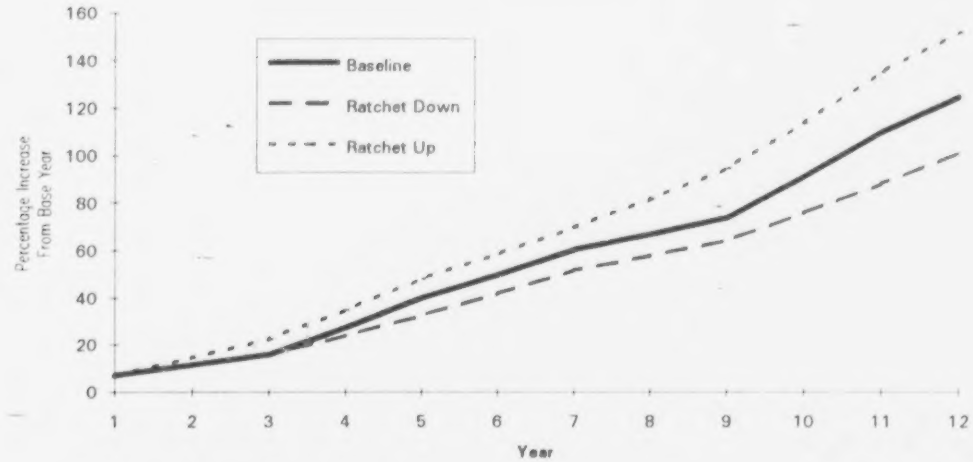
The shrinkers get their best shot at cutting back spending levels in recessions. If successful in resisting tax increases and fiscal gimmicks then, they should find that the rapid revenue growth and unexpected surpluses associated with economic recovery provide fertile grounds for tax cutting. Conversely, the expanders get their best shot in recovery periods when growth provides for apparently costless increases and the promises of future increases common in state school aid legislation. Come recession, a tax increase becomes a necessity to avoid painful cutbacks. If increased, the new tax levels become a starting point for the next cycle.

The challenge for the fiscal managers has always been to avoid these extremes. In good times, they husband resources by building reserves, accelerating payment schedules, making extra contributions to retirement funds, filling the coffers of rainy day funds, and spending on one-time items like capital outlays. In bad times, they reverse these strategies.

Impact Of The Strategies

Over the course of several business cycles, how successful these strategies are has immense impacts on the levels of state spending and taxes. The graph compares the results of a decade of each strategy at work. It is based on a **Reports** simulation of results when steady economic growth and inflation produce average annual revenue increases of about 7%, with no tax increases or cuts, and keep a state's share of personal incomes about constant.

Increase In Budgets
Using Three Strategies



The baseline reflects fluctuations in the rate of growth because of business cycles which drop the growth rate to 4% in some years and an offsetting 10% in other years. The line is the result if "maintainers" hold spending to revenues, no more and no less. If they successfully use rainy day funds and similar devices to smooth the impact of economic fluctuations, the growth would be a smooth 7% a year.

The Ratchet Effect

The graph shows that tax levels are changed significantly by the ratchet effect that occurs when strategies for shrinking or maintaining government operate over the course of business cycles. Like ratcheting devices in auto jacks and socket wrenches, these strategies hold any temporary gain, making it a starting point for the next gain.

In year two of the simulation, when growth falls to 4%, the spending forces obtain a tax increase to maintain 7% spending growth, so their line begins to diverge from the baseline. When growth rises to 10% they prevent tax cuts and then obtain another round of tax increases in the next recession. Tax rates rise in recessions and never fall. The shrinkers do the opposite. When revenues drop to 4% growth they drop the budget's growth by preventing a tax increase. When revenue growth rises to 10%, they allow spending growth of 7% and make 3% tax cuts.

In the twelfth year, the shrinking strategy would have produced a budget increase of 101%, only 80% of the increase from the baseline strategy. By ratcheting up, the expansion strategy would have produced a budget increase of 152%, 22% more than the baseline and 50% more than the ratcheting down strategy.

The basic problem for fiscal moderates in states like California and New York is that the devices to protect their options have failed. Knowing why they failed (e.g., not tried, not used enough, federal mandates, unusually severe state economic conditions) is important for future policy, but academic in the context of present choices. Assigning blame to particular individuals and political parties is inevitable, but doesn't make choices easier and may make later compromises harder.

The choices now being faced in some states look something like being asked to pick two to six (depending on the state) of the following: (1) tax increases too large to hide, (2) fiscal practices likely to reduce bond ratings, (2) layoffs, pay freezes, and unpaid days for state employees, (4) higher tuition, (5) school aid decisions inconsistent with teacher pay increases, (6) local aid cuts, causing local officials to blame legislators for spending cuts and local tax increases, (7) health care decisions incurring the wrath of doctors and hospital administrators and criticisms for depriving needy citizens of needed care, and (8) reducing standards of living for those dependent on state for income, a substantial number of whom are children.

The choices aren't made easier because legislators seeking reelection in November are being asked for on-the-record votes for policies with adverse consequences citizens will feel in the late summer and early fall. Nor are they easier because they presume legislators and governors won't achieve any of the initiatives they consider important, but will fail to keep promises made to voters and interest groups on a wide range of issues.

Under these circumstances, somebody has lots of explaining to do. Legislators and governors don't want to hear that their choices are so restricted and so unpleasant. They want full exploration of alternatives and enough public debate so that at least their supporters, if not their voters, will have some appreciation of their situation. This means time for witnesses to testify, protesters to protest, for interest groups to communicate with the grass roots, and for legislators to communicate with constituents.

Finding votes for tax increases is hard any time and harder in the many states where they will become partisan issues. Finding votes for measures that teachers, state employees, health workers, and local officials use as litmus tests for friends and enemies is no picnic either. Complicating it all is the apparent necessity to get votes for budget packages that have unusual combinations of positions -- such as asking tax increase supporters to support welfare cuts and employee pay freezes, asking opponents of higher social spending to sign up for tax increases.

As a result, the legislatures of California and New York have not followed the schedules that their governors have said must be followed. Some legislatures may this year, as last year, not finish their budget work until after the beginning of the new fiscal year.

HEALTH FINANCING UPDATE

There is much news but little new about state action on financing health care. This article highlights conclusions from past issues of **Reports** and provides updates on recent events.

Costs Rise, Federal Help Not On The Way

Non-Medicaid health costs are rising rapidly with adverse effects on firms, individuals, and state budgets. The good news, according to the survey by A. Foster Higgins & Co., is that 1991 employer health care costs didn't rise by 20% per employee as they did in the two prior years. The bad news is that large employers paid an average of $3,605 per employee, an increase of 12%. Total costs rose even faster, but employers shifted more costs to employees as deductibles, copayments, and coverage restrictions.

Federal action is unlikely this year. The President released his new plan in February, but without details on how its expensive vouchers and tax credits would be funded. It is now pending before the Congress along with dozens of other proposals, most of which are either vague on where the money comes from or are to be paid for by savings that knowledgeable observers don't expect them to produce. This means that candidates for federal office in 1992 will all be able to say they recognize the seriousness of health care financing issues and "have a plan" to deal with it. This step being completed, practically no one expects the next step, enactment of any plan.

A small industry has sprung up to summarize and compare the many different proposals for federal actions. Some comparisons are now being made on the relative elegance of the plans rather than their effects on the nation's health. For example, OMB Director Darman brags that the President's plan is "more detailed than 29 of the 31 plans that are out there."

Major State Plans On Hold, Minor Fixes Popular

The barriers to state universal health care plans are higher than ever. There are three massive restraints on state flexibility in adopting major changes in health care, such as their own version of the Canadian system or some of the play or pay plans: (1) tight state finances, (2) fear of interstate competition, and (3) large employers escaping state jurisdiction. Each restraint appears more binding this year than last year.

Tight state finances are eliminating many options. Most state-level plans require new state money for tax credits and coverage of the uninsured unemployed. These costs are rising as health costs rise and recession adds people to be covered. With deteriorating state fiscal circumstances, the potential for states to assume these costs is dropping.

Fierce competition limits costs states will impose on business. The second restraint is the fear of economic competition from employers in states not burdened with the taxes or cost of a state comprehensive plan. This fear increases with rising unemployment and increasing demands that states cut business costs to stay competitive. Despite tight finances, states are looking for ways to cut regular business taxes (Issue 4) in the name of economic development, debating reforms to Workers' Compensation to cut payroll taxes, and making concessions to keep plants open and attract the few new ones being built.

State powers to adopt universal care plans are limited. The third restraint is legal. States, except Hawaii which has an exemption for its pre-existing health plan, cannot regulate employer health plans because that regulation is preempted by the federal Employee Retirement Income Security Act. States might be able to avoid this restriction by using their taxing power. This was the legal theory of the Massachusetts plan that was adopted in the late 1980s but never implemented. However, attempts to regulate plans through taxation would, at a minimum, lead to extensive litigation on the preemption issue.

Current state regulation is based on state power over insurance. Employers avoid this regulation, such as mandated benefits, by not buying health insurance. Instead, they buy the administrative services of health insurance carriers and, in the eyes of the law, self-insure. The Higgins & Co. survey found self-insurance in 65% of the companies surveyed in 1991, up from 59% in 1990. Large employers can exempt themselves from state mandates by self-insurance because they have enough employees to spread risks. Medium and smaller employers don't.

Besides avoiding state mandates, such as required coverage of mental health, by self-insurance, companies can avoid insurance premium taxes. This makes such taxes an unrealistic way for states to finance coverage for the uninsured.

Many dramatic plans are being introduced in the states but none have been implemented. Governor Gardner devoted his entire state-of-the-state message to health issues. Saying that the people of Washington are "tired of waiting for that perpetual future called 'after the next election," he called for a comprehensive play or pay plan with the state contribution to be funded by higher taxes on insurance (auto, business, and homeowners) and on tobacco and alcoholic beverages.

Labor-oriented groups around the country have developed play or pay plans which have been introduced in many legislatures. These generally have a substantial employer payroll tax and a lesser employee payroll tax (e.g., 9% for employers and 1% for employees in the Vermont and West Virginia versions). The proposal that failed in the California Senate in late January was a Canadian-type plan with a 10% payroll tax paid entirely by employers and an added tax of 1.5% of personal taxable income.

A plan proposed by California's insurance commissioner envelopes the health care components of Workers' Compensation and auto insurance, permitting lower payroll taxes (averaging 6.7% but up to 8% for employers, 1% for employees). It drew the editorial endorsement of the New York Times (2/17) as a "model for every state," but has many local critics.

Minnesota's plan made it through the legislature (D-majority) last year but was vetoed by the governor (R) as too expensive. This year, negotiations are underway to develop a plan that can pass and be signed. The governor is said to be willing to back spending to cover the uninsured and revenue losses from income tax deductions or credits. But implementation might be set for some future year. There is general agreement that a substantial budget deficit exists and that taxes won't be raised in 1992.

Some proposals cover only specified target groups. Pennsylvania's would cover uninsured children up to age 6 in low and middle income households. The Indiana plan would have broader coverage but be limited to catastrophic costs. The governor's proposal in Delaware would be limited to poor children up to age 18.

Plans being offered as initiatives to cut health costs often consist primarily of waivers of current state mandates and cross-subsidies among the privately insured. The small business package recently offered by Florida's insurance commissioner and endorsed by Associated Industries of Florida and the Florida Chamber of Commerce is a good example. A new "basic" policy is authorized. It exempts small businesses from the state's mandatory coverages. These range from inexpensive acupuncture coverage to the expensive coverage of mental and nervous disorders. It adds requirements to prevent gaps in coverage including eliminating waiting periods when employees change jobs and blacklisting of high-risk employers.

Some state officials recognize the parallels between cross-subsidies in health insurance and cross-subsidies in other state policies. For example, Governor Ashcroft describes his Missouri plan as ending experience rating for small business health coverage. The experience rating term is used in Workers' Compensation and Unemployment Compensation where states charge higher payroll taxes to firms whose employees generate disproportionate claims. For the same reasons being argued in health insurance (coverage nearly unavailable or available only at extremely high prices) states limit experience rating for WC and UC. Another parallel is risk pooling used to provide affordable auto insurance to drivers with bad safety records.

Studies and task forces are still popular, with a new wrinkle of adopting a plan that is yet to be designed. As usual, there are many proposals that combine: (1) relatively inexpensive initiatives within the scope of current state responsibilities for Medicaid, public health, and insurance regulation and (2) studies of the larger issue of what to do about the uninsured. Studies with reports scheduled after the next election are subject to the criticisms like those made by Governor Gardner (see above) and because this option has already been used in many states. As a result, several of the proposals have specific dates for implementation of a plan yet to be fully designed. The Minnesota plan has this element. Governor Chiles' proposals for Florida also follow this model.

Medicaid Bringing More Bad News

Growing Medicaid costs are chewing up state budget flexibility and increasing pressures to raise taxes. The widely reported partisan flap at the February National Governors' Association meeting was over the timing of Governor Romer's comments to President Bush about federal policy, not the substance of his concern:

> *I have to leave today and go to Colorado and advocate a tax increase. You know why? Because Medicaid expenditures that have been put upon us by the federal government are more than our present budget can handle.*

He continued, *That means while I'm here I have an obligation to talk to the President before the press.* Not all governors agreed with that part. Not all governors were going home to propose tax increases either, nor is the Colorado legislature happy about Romer's proposals. But the legislature, like many governors, is committed (by past legislation in Colorado and some other states) to major school aid increases. Like some other states, Colorado may be able to cover Medicaid, deliver for public schools, and avoid tax increases. But the price must be paid somewhere (see higher education in this issue).

In their budget and state-of-the-state messages, governors said all kinds of nasty things about Medicaid and federal mandates. Looking at costs rising 16% a year, Hawaii's Governor Waihee talked of Medicaid as a "budgetary PacMan." Governor Thompson said Medicaid is "crowding out necessary investments" in other critical Wisconsin programs. Governor Campbell talked of a federal "Medicaid stranglehold." Referring to total state health care costs, not just Medicaid, Governor Gardner used the PacMan analogy in a USA Today (2/10) interview,

State attempts to control Medicaid costs aren't working well. Each attempted Medicaid cut brings a story of its own, many resulting in less savings than anticipated because implementation is blocked in the courts, decisionmakers back away from the changes, cost-increasing modifications are made, or implementation and thus savings are delayed. Frequently, the outcome is a combination of these results.

New York's payment for drugs is an example. New York pays pharmacies $2.60 per prescription plus 90% of the wholesale price of the drug. Determining the wholesale price is as tricky for New York as looking at the dealer's invoice is for car buyers because of discounts not in the price. New York began trying to reduce reimbursements in 1987, but was tied up in court by the pharmacists until January.

After litigation succeeded and negotiations with pharmacists failed, the state announced that lower rates were going into effect in mid-February. Pharmacists complained in every forum available. Some said they would no longer fill Medicaid prescriptions. Some legislators counseled delay so pharmacy reimbursement issues could be considered in the context of long-stalled budget negotiations, where reimbursement policies for all health care providers are a key issue. For whatever reason, the governor announced just before the scheduled implementation date that the changes would be postponed.

Medicaid Cost Controls At Work

The federal government has forced the Massachusetts Department of Public Welfare to rescind, retroactively, Medicaid regulations that could force the sale of a Medicaid recipient's house. The primary reason for the turnabout was not that the house can never be a countable asset under certain circumstances, but rather that Massachusetts regulations violated the federal regulations, which must be followed if the house is to be considered a countable asset. -- Boston Globe, January 23, 1992.

Massachusetts rules permitting families using Medicaid for nursing home costs to keep assets have been more liberal than those of many states. The subject is of such interest that the Boston Globe runs a column about it. A recent one (1/23) was titled, "Creative Use Of Annuity Can Soften Medicaid Asset Rules." It included discussion of a new book (Alexander Bove, The Medicaid Planning Handbook, Little Brown & Co., 1992). The book could have been titled how individuals can make states spend more on Medicaid. After several years of debate, the state attempted to tighten its regulations. The result appears on the bottom of page 16.

Last year, many states balanced their budgets by counting on savings in their Medicaid programs, a practice some states have been using for years. The FY 1992 returns are coming in with unimpressive results, as supplemental appropriation requests mount.

Cost Increasing Medicaid Problems Keep Appearing: New York and about 30 other states are affected by litigation over Medicaid recipients who are eligible for Medicare. States buy into the optional Medicare coverage (Part B) for expenses like physician visits. Medicare pays for 80% of these costs, patients pay the other 20%. Some states pay the other 20% for Medicaid recipients, which is what health care providers want. The other option is to leave the patient responsible. In practice this means physicians get 80% of their approved Medicare reimbursement, with a minimum payment of the lower Medicaid reimbursements. New York, one of the states not paying the 20%, lost a 2-1 federal Second Circuit Court of Appeals decision in February.

Like many complex Medicaid issues, this one is full of ironies. At one time it was apparently a federal rule that encouraged states not to pay the 20%. The plaintiff in the New York case is a public body -- the New York City Health and Hospitals Corporation.

The Second Circuit decision is not binding in other circuits, so only Connecticut, New York, and Vermont are immediately affected. Similar cases are likely in other circuits. The case could reach the U.S. Supreme Court by discretionary review of the New York case and would likely be taken by the Supreme Court if other circuits decide the case in favor of the states.

HIGHER EDUCATION STRATEGY

If we don't {raise tuition}, we have two nightmares. One is the nightmare of eroded quality. The other is the nightmare of fewer students.

This testimony of the head of the California State Universities (CSU) to a legislative committee is typical of what legislators are being told about higher education this year.

Funding Increases Unlikely

Most higher education officials are accepting the premise that they will be lucky to get any increases in state aid this year. They have considerable evidence to go on, including last year's experience, governors' budget recommendations, what legislators are telling them, and their assessments of what legislators are likely to do given the fiscal circumstances they face.

Higher Ed. Budget Changes In FY 1992, Percentages

U.S. Average	**0.7%**
California	-2.0
Colorado	3.0
Florida	-5.3
Illinois	0.6
Massachusetts	-16.2
Nebraska	4.0
New Jersey	0.0
New York*	-5.8
North Carolina	0.0
Ohio	-0.1
Oregon	4.5
Pennsylvania	6.9

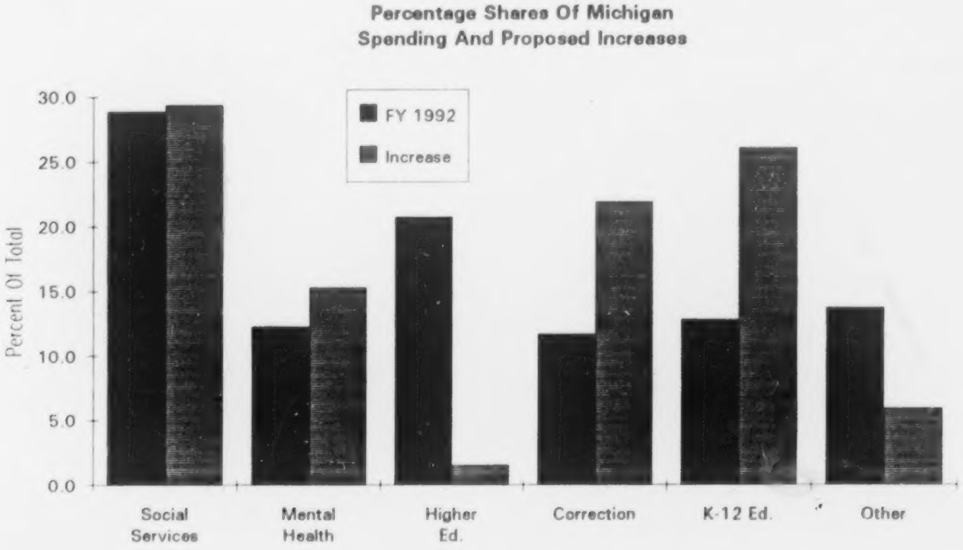
A recent survey shows that a rash of mid-FY 1992 budget cuts brought the average increase in higher education budgets to 0.7% over FY 1991, well below the inflation rate of 3-5%. The table shows budget changes.

The survey by the American Association of State Colleges and Universities found that tuition and fees increased about 13.6%. State student aid increases of 5.4% were not sufficient to cover the increases for those students receiving aid, requiring some combination of providing aid to fewer students and providing less aid per student. One question concerned the outlook for FY 1993 budgets. Only five responders felt that the situation would improve, while higher education officials in half the states thought it would be worse.

The outlook for higher education funding in FY 1993 is at least as grim as in the current year. Tax increases are under consideration in only a few states. Without them, the limited new money available is being absorbed by increasing costs of social service programs, particularly Medicaid, and corrections. Attempts to provide school aid (K-12) increases at least matching inflation are eating up the rest, sometimes more than the rest. Constrained by a fixed total and crowded out by other increases, higher education doesn't get much. This year's they-never-knew-what-hit-them award goes to higher education officials of 12 states who said in the survey that Medicaid, corrections, and other spending hadn't had a negative effect on their budgets.

In no-new-tax environments, the best place to look for significant increases in higher education funding is those states whose governors are drawing nationwide attention for cracking down on social welfare spending, California and Michigan. The new California budget contains only an 0.2% increase in general fund spending. But its proposed cuts of 10% in welfare (AFDC) and 12% in Medicaid leave room for significant increases elsewhere. Those go to K-12 education (8%) and community colleges (10%) consistent with minimum increases required by Proposition 98. Leftovers go to the University of California (1.5%), CalState (1.4%), and student aid (1.1%).

Michigan's situation is shown below. Corrections and public schools are the big gainers. Social services (including Medicaid) holds its own, but will show much larger increases through supplemental appropriations if Michigan follows past patterns. Higher education is nearly a fifth of the budget, but its share of new money is so small as to barely be visible on the graph.



Less Bucks, Less Bang

Usually implicitly, sometimes explicitly, state higher education officials are accepting the premise that their notions of what constitutes "quality" are approximately correct. Those concepts include faculty pay and teaching loads competitive with comparable institutions. From these premises, the trade-offs are inescapable:

- To maintain quality and serve the same number of students, tuition must be increased substantially.
- Without major increases in state aid or tuition, quality can only be maintained by sacrificing quantity, the number of students.

So the California State administrator told legislators that a 40% "fee" increase would still require some cuts, but would maintain the system. Without it, he said enrollment on the system's 20 campuses should be dropped to maintain quality. Such a drop would spread available state aid over fewer students, thereby enabling the system to increase per student funding -- a proxy for quality -- without increases in overall funding.

More Bang For The Buck

Legislators in California and elsewhere don't want to hear that their only choices are spending more, charging students more, or serving fewer students. Their questions run to getting more out of money already spent. Key to that discussion is the number of courses professors teach and the number of students in each course. So much money is involved in those decisions (and pay levels) that the rest is, so to speak, academic.

At CSU, individual faculty members have apparently been making their own adjustments by letting more students into courses than they have to. CSU's chancellor told the House committee that this wasn't helping the situation: "it just shows we are willing to water down quality. That's not the message we want to send."

Some California legislators are unhappy with current faculty workloads and even less happy with the reductions in teaching loads negotiated with faculty members last year. The chairman of the Higher Education Committee in the House recently commented:

> *For years, universities faced with decreasing budgets would rather get rid of students than increase faculty workload. They all want to be like Harvard and lessen the teaching load. That can't continue.*

Arizona's legislative fiscal staff took the issues to the higher education community with a commentary by one of its analysts -- "Tight Budgets Demand Studies Of Faculty Productivity" -- in the Chronicle Of Higher Education (2/19).

RESOLVING NEW YORK'S FINANCES

> *This year, "timeliness, timeliness, timeliness" should be the mantra repeated everywhere in the Capitol.*

This was Governor Cuomo's exhortation to the legislature as he presented his budget for FY 1993, which begins in April. Back in December when a large deficit in the FY 1992 budget was acknowledged, the governor urged quick action but didn't get it. Now the hope is for action before April 1, an objective last achieved in 1984.

Why Governor Cuomo Didn't Run

When Governor Cuomo was considering running for President, he consistently said that budget action or inaction and the state's fiscal situation would be the determining factor in his decision. When he decided not to run, he gave the same reason. **Reports** cannot psychoanalyze motivation, but can report that New York's fiscal situation and traditions of gubernatorial leadership in the budget processes make the governor's presence more important than in most states.

Budget Negotiations In New York

For at least a decade, New York's budget decisions have been made in summit negotiations involving the governor (D), Senate leaders (R), and House leaders (D) -- each with significantly different perspectives. These negotiations encompass most major money-related decisions including the amounts and distribution formulas for local government and school aid, revisions in state mandates, welfare payment levels and eligibility, the scope of the Medicaid program and provider reimbursement rates, university support and tuition levels, employee pay and benefits, and many details of state operations. Major financial management matters are also on the table in these sessions. They include the financing of state authorities, borrowing plans, and timing of receipts and outlays. Tax issues are always present. Even to continue tax policy unchanged, legislation is required because changes, including a reduction of personal income tax rates, are scheduled under current law.

Each of the participants carries well-publicized postures into these sessions. The Senate majority is most supportive of local aid, particularly school aid, opposed to tax increases and sometimes seeking cuts, and looking for cuts in income-tested programs and operations of state government. The House majority is strongly attuned to the financial condition of New York City, less supportive of local aid elsewhere, and more supportive of income-tested programs and state operations, including concerns of employees over pay and benefits. The governor is cast in the role of maintainer of fiscal discipline, siding with the House to avoid unrealistically high revenue estimates and unaffordable tax cuts and with the Senate to avoid steep tax increases, more extensive borrowing, and unrealistic expectations about the effectiveness of spending controls.

Choices Are Limited

The negotiations are always time-consuming and difficult and promise to be triply so this year. They are considerably more difficult than in most states because the options are more restricted.

Raising taxes isn't easy anywhere, but is harder in New York. Taxes are roughly a third above the national average, higher than any other state but Alaska, and higher than neighboring states despite the recent increases in Connecticut, New Jersey, and Pennsylvania. Business makes the usual arguments which have immensely more salience because Fairfield County, Connecticut and neighboring New Jersey areas obviously owe much of their prosperity to firms and individuals that have their economic ties with New York. Brick-and-mortar proof makes the anti-tax argument considerably more persuasive than more academic sounding arguments in states such as Florida and Texas, or even California and Minnesota. Governor Cuomo insists that the state cannot raise taxes to pay for social programs because the resulting undermining of the state's economic base would defeat its future ability to pay even for current social programs.

Dumping fiscal responsibilities on local governments isn't easy anywhere, but is harder in New York. New York City is inherently one of the jurisdictions to be dumped on. The city's taxes are very high by national standards and its fiscal problems legendary. The current generation of state decisionmakers lived through the city's fiscal crisis of the mid-1970s, which seriously threatened the economic as well as fiscal viability of the city and required a massive state bailout. State officials believe, with considerable justification, that they cannot permit New York City to develop like situations of some smaller jurisdictions elsewhere supposedly resulting from state policies -- Chelsea in Massachusetts, Bridgeport in Connecticut, East St. Louis in Illinois, and Northern California counties.

New York is either at the end of its rope or close to the end in the use of borrowing and exotic financing arrangements. This year, states like Indiana, Mississippi, Texas, and Virginia are relieving pressures on operating budgets by shifting capital outlays, like prison construction, to bond-financed capital budgets. New York did that decades ago, with a major part of the problems of the 1970s arising because operating costs had been loaded atop capital costs and financed by borrowing. On-the-books borrowing is already so substantial that the state vies (with Louisiana and Massachusetts) for the lowest state bond ratings in the nation. New York has pioneered in borrowing by state authorities, which it has in substantial numbers.

The limits of this policy were discovered in the 1980s when the state dormitory authority ran into financial difficulties. The state came to the rescue on the theory, widely supported on Wall Street, that the authorities were so integral to the state's finances that one could not be allowed to fail without undermining confidence in the state's own bonds. New York also pioneered in shifting financing even farther from its operating budget by having local governments buy or build and leasing from them. Even the buildings in which state officials discuss fiscal problems were built by others and leased to the state. Recently, the state has sold assets and leased them back, including Attica prison.

Special problems make budget cuts more complex. Many pieces of New York's public and private economies are inextricably intertwined to a much greater degree than in other states. The state runs the retirement system for jurisdictions other than New York City. It has changed retirement contribution requirements to ease the pain of state budget cuts, but then must make special arrangements for the city to provide comparable relief. Local governments cover half the costs of Medicaid, so savings in the state's budget produce parallel savings in local budgets. But when the state balances its budget based on expected savings that aren't realized, the resulting shortfalls occur in local budgets as well as the state's.

The state has a large not-for-profit sector providing children's services, health care, day care, community mental health, addiction services and more. The viability of this sector is closely tied to state budget decisions.

The contrast with other states is illustrated by bill paying in health care. Illinois has been avoiding running out of cash by delaying payments to Medicaid providers. This has produced considerable criticism as poor financial management and anguish among the providers because delayed payments are *de facto* reimbursement rate cuts. It hasn't resulted in closed facilities or much public reaction.

New York recently resorted to the same device while its officials discused possible Medicaid cuts in general terms, as is happening in nearly every state. This combination brought an estimated 20,000 people to the streets of New York in protest. On page 17 of this issue an obscure rate reimbursement issue is used as an example of judicial pressures on Medicaid costs. The dispute is between a deficit-ridden state and a deficit-ridden authority that runs public hospitals in New York City. This kind of interconnection makes cutting Medicaid much more difficult than in other states -- not because the effects on unserved patients are different or greater but because the viability of many public institutions is more closely tied to the policies and spending of other public institutions.

New York Governors As National Candidates

If Governor Cuomo were to run for President, New York finances would surely be an issue. Assessing them in a national context depends on whether the focus is on state practices or changes in state practices.

If one looks at the *changes* in state policy during his terms in office, Cuomo is in defensible shape relative to the President and many other governors, including those of Arkansas and Virginia. A recent assessment by the conservative CATO Institute compares governors' fiscal policies and concludes, "Mario Cuomo's reputation as a tax-and-spend liberal may only be half-deserved." Looking only at *changes*, proposed or enacted, Cuomo is in much better shape than Governor Clinton, who has consistently argued for a decade to raise taxes for better schools.

The vulnerability of New York governors, going back to Rockefeller, on state and local finances is on the *status* of taxes and spending, not the *changes*. The status lends itself to many unfavorable one liners. Examples: if all states had the tax levels of New York, state and local tax bills would be x% higher. If all states had as large a proportion of their population on welfare as New York, x million more Americans would be on welfare. If New York's Medicaid practices became national policy, costs would soar by $ billion. These *status* statistics immunize Governor Clinton because of the state's below average taxes and spending. He can rightfully contend that even if the Arkansas legislature had adopted every penny of his tax increase recommendations, applying Arkansas policies nationwide would reduce taxes for most Americans.

These observations have a flip side. If the test isn't low tax levels but high service levels, New York gets credit for its spending patterns and Arkansas credit for increases.

BALANCED BUDGETS AND REVENUE ESTIMATING

State officials like to contrast the federal deficit with the states, noting that 49 states have balanced budget requirements. As spring nears with state budgets not balanced, the balance requirements are getting a harder look. The requirement is typically not that the year end in balance but that balance be respected in the budget submission, the enacted budget, or both. The conclusions of Michigan's Senate Fiscal Agency are typical:

> *It appears clear that the intent of the State Constitutional [Convention] of 1963 is to ensure a balanced budget. However, and as restated from the Convention comments, "there is no apparent way of forcing a balanced budget." It also seems apparent that the Constitutional Convention delegates anticipated deficits and that, if one did occur, it was to be resolved in the ensuing fiscal year. In addition, if deficits were to occur in two or more successive fiscal years, there are no direct penalties that could be assessed or imposed.*

When major revenue estimating errors arise, as happened this year, there is considerable interest in improving the revenue estimating process. Eileen Shanahan examines state and local revenue estimating in "Cracks In The Crystal Ball" (Governing, December). The Federation of Tax Administrators has a new survey of state organizational arrangements for the revenue estimating function (Tax Administrators News, November).

There is a continuing tension between those who consider revenue estimating a technical function with results to be judged by how close estimates come to actual revenues and those who consider revenue an integral part of overall budget policymaking that also includes spending decisions, caseload estimates, and reserve funds. Deliberately conservative estimates are used in some states as hedges against errors. Deliberately generous estimates are sometimes used, particularly in late-stage legislative negotiations, to provide just a little more money to make agreement possible.

State officials are often aware of the link between revenue estimates and spending plans. Governor Cuomo provides an example. The estimates in his FY 1993 budget are based on the same pace of economic recovery assumed in the federal budget. At the press session when he released his budget, a reporter from Newsday (which serves Long Island) asked why, given past overestimates, he didn't use more conservative estimates. His response: "Because I'd have to kill your schools on Long Island and you'd crucify me."

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STATE POLICY REPORTS

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Sharp differences in the performance of individual state economies are narrowing as recession drags high-flying states down and the Northeast bottoms out. Except for California, Western state economies are outperforming the nation's. A new assessment pinpoints how defense cuts will affect individual state economies.

- State Economic Momentum p. 6
- Impacts Of Defense Spending Changes p. 10

A new study purports to show which governors are best but may just show how fruitless such studies are. Comparing policies of states is more justifiable, but both difficult and controversial. A complex assessment of state environmental conditions and policies contrasts with a magazine's appraisal of recent "worst" state decisions..

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Corporate income taxes are becoming a less significant revenue source, as federal and state officials quietly alter credits and deductions without lowering rates. Pennsylvania is bucking a trend, or perhaps establishing a new one.

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Technical notes detail sources and caveats, including some of the problems of finding data by which to judge performance of governors.

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March 1992 (Second Of Two March Issues)

FEDERAL POLICY AND STATE ISSUES

Fed Bashing Remains Popular

> *It seems there is a rebellion brewing among the governors. ... It is time for states to decide, not Congress, what is a fair level of taxation for state taxpayers.*

This was one of many criticisms Governor Wilson made of federal policy when he ventured inside the Beltway (where he previously served as U.S. Senator) in late January. His criticisms were particularly pointed in a National Press Club appearance where he fielded a series of questions about California budget cutbacks by suggesting that elected officials shouldn't be in office and the people ought to throw them out if "they cannot discuss the competing claims upon the treasury of the state or the nation, if they are too damn cowardly to support the need for honest discussion of competing claims."

In his state-of-the state message, Governor Bayh compared the federal government to the British government of the 18th Century and the former government of the USSR:

> *During the last month we have witnessed one of the most remarkable events in world history. The government of the Soviet Union, bloated with bureaucracy and wildly unpopular for the abuse it inflicted on both its citizens and constituent states, was simply abolished. Their experience is not much different than our own 200 years ago. Our forbearers, tired of taxation without representation and a distant, unresponsive bureaucracy, rebelled, and America was born.*
>
> *While I don't contend that the federal government of the United States is as bad as the former Soviet Union or King George, I have a pretty good idea how Boris Yeltsin and George Washington felt.*

These comments are typical of the high levels of criticism of federal policy taking place throughout state governments. They span the political spectrum. The most immediate concerns are with federal mandates driving costs in state and local budgets and with action and inaction contributing to the recession. Officials of the states most affected by immigration -- such as California, New York, and Texas -- are concerned over administration of immigration laws and the imposition of substantial costs by the federal government without offsetting compensation for states' out-of-pocket costs. In the West, particularly Alaska and Oregon, there is concern that national rules limiting resource development are constraining state economies. In some Midwestern states, there is resentment of federal policies that appear to siphon money out of state economies for the benefit of other regions -- acid rain mandates, federal highway funds, and the savings and loan and bank bailouts.

Economic Policy And Economic Stimulus Packages

Much national attention is now devoted to the relative merits of competing Presidential and Congressional proposals to stimulate the economy. Most of the action is in tax law modifications, but there are also many proposals to increase federal spending on public works.

There is considerable partisan debate over the relative merits of the competing approaches both as tax policy and in terms of their effectiveness in causing economic recovery. While some state officials are entering the national debate, the working levels of state government are assuming that its outcome will have essentially no net impact on state finances by changing the timing and magnitude of economic recovery. The assessment by the Illinois Economic and Fiscal Commission in its Winter Update (February) is representative. It discusses possible federal action as one of many factors -- consumer spending, interest rates, exports, and more -- potentially affecting the economic outlook. It comments:

> *Federal policy in terms of taxes and spending also is likely to become more stimulative, although to what extent is unclear. Any tax cuts or spending increases are likely to be limited given the fear of generating still-larger federal budget deficits.*

The California legislative budget office has concluded that the budget submitted by Governor Wilson is now out of balance by massive amounts -- $2.8 billion this year and as much as $6 billion in FY 1993. The governor concurs that some adjustments are needed. The culprit is primarily the recession, with the timing of recovery key to how hard it will be to balance the new budget. In this context, the fiscal office doesn't mention federal economic stimulus packages as possible salvation. In its listing of downside risks, it cites two problems associated with the speed, not the substance, of possible federal action: (1) delays in federal decision on pending waiver requests affecting the state's welfare program, and (2) the risk that "delays in action on the federal budget and tax changes defer economic activity."

Somewhat ironically, the federal legislation with the most immediate potential impact on state spending simply corrects an error by which the Congress inadvertently cut highway funds for this fiscal year by $1.1 billion by authorizing work on a post office in Brooklyn and several smaller items. The complex federal budget procedures, which caused the error, mean that correcting it raises collateral issues. As a result, states are likely to put less highway construction under contract this year than state officials want or federal officials intended.

Tax Law Changes, Effects On States

Practically all of the federal tax law changes in the economic stimulus packages will have significant parallel effects on state tax policies and revenues. In general, provisions that reduce federal revenues would cut state revenues while actions to increase federal revenues would increase state revenues. Many of the packages are designed to stimulate the economy by adding purchasing power, primarily taking less out in federal taxes while either increasing federal spending or leaving it unchanged. States would benefit from whatever economic activity tax cuts stimulated but lose revenue from the changes.

The interactions of federal and state tax codes are highly complex and vary with the type of tax provision changed at the federal level and the unique characteristics of both each state's tax code and its laws and traditions in conforming to federal changes. Federal changes affecting the definitions of income (e.g., depreciation rules, treatment of Individual Retirement Accounts) are difficult for states to avoid. Federal changes affecting tax-rates, imposing surcharges, and giving special credits are more easily avoided. These and other aspects of the impact of pending federal changes are comprehensively described and assessed state-by-state in a recent publication by the state tax administrators.

Tax Law Changes, Parallel Federal And State Issues

While the dollar impacts of the federal changes under consideration are relatively small, the issues they raise, such as how to provide incentives for investment and what is fair treatment of rich and poor, are the same as those involved in much larger federal changes. This means the issues have a high philosophical content relative to their economic effects, a recipe for long debate. As a recent assessment by Goldman Sachs put it, "With little scope for increasing the size of any stimulus, the two parties appear limited to a squabble about how to distribute whatever meager changes can be made."

Many of the proposals at the federal level have parallels at the state level, particularly in those states, such as California and Wisconsin, that are relatively adventuresome in maintaining state income tax provisions deviating from federal ones. It is hard to tell whether federal officials are following state officials, state officials are following federal officials, or both are responding independently to underlying national problems and concerns. The major concepts appearing in proposals at both the federal and state level are:

> **Lower Taxes On Low-Income Wage Earners**: The concept is to cut taxes paid by those earning about what they would get in welfare payments and varying segments of the near poor. The mechanisms are higher personal exemptions, special credits or exemptions for children, and tax credits -- all designed to exclude higher income taxpayers.

Incentives For Individual Savings And Investment: The concept is to encourage investment by sheltering savings from taxes and lowering taxes on investment gains. The mechanisms are lower capital gains taxes, more flexible rules for tax-free contributions to and/or withdrawals from special retirement accounts like IRAs, and permitting individuals to participate in the same incentives as corporations.

Incentives For Business Investment: The concept is to encourage business investment and competitiveness by lowering taxes when such investments are made and/or increasing the after-tax rewards when they succeed. The mechanisms are lower capital gains taxes, a lower tax rate on corporate income, investment and R&D credits, and more liberal depreciation.

Higher Taxes On The Affluent: The concept is to make income distribution, and the sharing of tax burdens, more fair by taking a larger percentage of high incomes. The methods are a higher tax rate on incomes above about $100,000, raising the alternative minimum tax, and restricting the value of exemptions and deductions to high bracket taxpayers.

All of these concepts can be found in tax legislation introduced in the legislatures this year. Few of these measures will pass. Revenue-cutting measures, excepting some highly targeted business tax incentives for economic development, are being ruled out because states cannot afford the revenue loss. Revenue-raising measures are ruled out, at least so far, because elected officials in most states are trying to maintaining a posture of not increasing taxes this year.

The Federal Budget

In discussing their budgets, state officials are assuming that federal spending policies will remain essentially unchanged in FY 1993. This would mean that Medicaid and AFDC would grow automatically in response to increases in caseloads, prices, court decisions, and policy decisions by the individual states. The President's budget assumes this will mean federal Medicaid costs will increase by 16.4% in FY 1993, implicitly estimating that state-funded outlays will also increase by 16.4%. The likely federal spending for all other programs would show slower growth than inflation. In the President's budget, the growth for all grants to state and local government other than Medicaid would be 2.2%.

Two major policy changes recommended by the President aren't affecting state debates this year because there is considerable skepticism over whether they will be enacted and, if enacted, are not likely to take effect until after FY 1993. They are: (1) a new proposal for block grants to replace many categorical grant programs and (2) a proposed cap on Medicaid spending closely tied to the President's broader proposals for health policy.

STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The latest Index of State Economic Momentum (see Technical Notes for details) shows continued uneven growth in state economies.

Index Of State Economic Momentum, March 1992

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	2.39%	18	Louisiana	0.79%	35	Virginia	0.08%
2	Utah	2.17	19	Mississippi	0.78		**United States**	**0.00**
3	Nebraska	2.11	20	Wisconsin	0.72	36	Illinois	-0.04
4	Idaho	2.10	21	Kentucky	0.69	37	California	-0.07
5	Arkansas	1.92	22	Indiana	0.55	38	Pennsylvania	-0.22
6	Oregon	1.60	23	Florida	0.52	39	Missouri	-0.42
7	Hawaii	1.49	24	Oklahoma	0.51	40	Michigan	-0.56
8	Texas	1.40	25	Tennessee	0.49	41	Georgia	-0.57
9	Arizona	1.24	26	North Dakota	0.49	42	Maryland	-0.71
10	South Dakota	1.19	27	Alabama	0.48	43	Vermont	-1.00
11	Washington	1.17	28	Delaware	0.36	44	New York	-1.34
12	Colorado	1.11	29	South Carolina	0.32	45	New Jersey	-1.52
13	New Mexico	1.10	30	West Virginia	0.17	46	Connecticut	-1.55
14	Alaska	0.90	31	Iowa	0.16	47	Maine	-1.71
15	Montana	0.89	32	Wyoming	0.14	48	Rhode Island	-1.71
16	Kansas	0.80	33	North Carolina	0.13	49	New Hampshire	-1.88
17	Minnesota	0.80	34	Ohio	0.10	50	Massachusetts	-2.43

Every one of the states in the top third in economic performance is West of the Mississippi River. Thirty-five states beat the national average, which is set as the Index benchmark of 0.00%. This occurs because growth is concentrated in smaller states while larger ones like California, Georgia, New York, and Pennsylvania have been turning in sub-par performance. Reflecting recession, the national average itself is sub-par, so states in the bottom third of the table are running at the back of the pack in a slow race.

It is extremely difficult for any state to outperform the national averages consistently. States which do, as New England did several years ago, can easily crash to the bottom, as those states have done. Good times tend to lead to overheating and eventual declines. This appears to be happening to Nevada now, as it did to Arizona before it. While first, Nevada's margin over other states is much less than in the Index when it was last published (Issue 24 of 1991). Resource-reliant states like Oklahoma and West Virginia hit bottom in the 1980s and now are ahead of the national pace. Every one of the eight lowest states on the table is closer to the national average than it was in the December 1991 Index.

Employment Change

The United States lost about 830,000 jobs from December of 1990 to December of 1991, a decline of 0.76% compared with an increase of around 1.5% that should prove to be about the annual growth rate for the 1990s. The job loss was highly concentrated in a few industrial states -- 267,200 in New York, 149,500 in California, 138,300 in Massachusetts, 95,200 in New Jersey, 70,900 in Georgia, and 64,000 in Connecticut. Twenty-six states, mostly less populous Western states, gained jobs. The percentage changes are shown in the table.

Percentage Change In Employment, December 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	4.05%	18	Arizona	0.74%	35	Washington	-0.73%
2	South Dakota	3.53	19	West Virginia	0.60		**United States**	**-0.76**
3	Arkansas	3.46	20	Indiana	0.60	36	Florida	-0.79
4	Idaho	2.60	21	Kentucky	0.55	37	Pennsylvania	-0.88
5	Utah	2.13	22	New Mexico	0.46	38	California	-1.15
6	Alaska	1.67	23	Oklahoma	0.38	39	Michigan	-1.52
7	North Dakota	1.56	24	Iowa	0.27	40	Missouri	-1.96
8	Oregon	1.38	25	Nevada	0.25	41	Rhode Island	-2.23
9	Kansas	1.21	26	Wyoming	0.10	42	Vermont	-2.29
10	Montana	1.10	27	South Carolina	-0.01	43	Georgia	-2.35
11	Colorado	1.09	28	Ohio	-0.06	44	Maryland	-2.36
12	Texas	0.95	29	Illinois	-0.30	45	New Jersey	-2.60
13	Hawaii	0.91	30	Delaware	-0.32	46	Maine	-3.17
14	Mississippi	0.88	31	Tennessee	-0.40	47	New Hampshire	-3.18
15	Louisiana	0.84	32	Alabama	-0.43	48	New York	-3.26
16	Minnesota	0.75	33	North Carolina	-0.47	49	Connecticut	-3.87
17	Wisconsin	0.75	34	Virginia	-0.65	50	Massachusetts	-4.68

The top five states are the current economic success stories. All can point with pride to success stories in the private sector -- software companies in Idaho and Utah, Wal-Mart in Arkansas, telemarketing and credit card operations in South Dakota, and ConAgra in Nebraska. In all of these five, state officials can (and do) claim they have pursued policies to create an environment for this successful entrepreneurship. In Nebraska and South Dakota, specific changes in state policy -- taxes in Nebraska and regulation and taxes in South Dakota -- were made to encourage the development that has now materialized.

New England states dominate the bottom of the list with other Eastern states -- Georgia, Maryland, New Jersey, and New York -- interspersed. The award for winning by not losing goes to the Industrial Midwest with states close to the national average. In most recessions, these states, with their emphasis on manufacturing, do worse than average.

Personal Income Growth

During the quarter ended last September (latest data available), personal income grew by 2.8% nationally from the same quarter of 1990. The increase is less than the rate of inflation in the same period, reflecting a decline in purchasing power as the recession's impacts appear. The state-by-state changes shown in the table are a good indicator of where the recession has been felt the most.

Percentage Growth In Personal Income, Third Quarter, 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Utah	6.2%	18	Oklahoma	4.1%	34	Florida	2.8%
2	Hawaii	5.2	19	Nevada	4.0	34	Illinois	2.8
2	Idaho	5.2	19	Wyoming	4.0	34	Iowa	2.8
4	Louisiana	5.1	21	Kansas	3.8	37	North Carolina	2.7
5	Texas	5.0	21	North Dakota	3.8	38	Virginia	2.6
6	Arkansas	4.9	23	Minnesota	3.6	39	Georgia	2.4
6	Nebraska	4.9	24	Indiana	3.5	40	Michigan	2.2
6	New Mexico	4.9	24	West Virginia	3.5	41	California	1.9
9	Arizona	4.6	24	Wisconsin	3.5	41	Connecticut	1.9
10	Colorado	4.5	27	Alaska	3.3	41	Maryland	1.9
10	Montana	4.5	28	Missouri	3.1	41	New York	1.9
10	Washington	4.5	29	Delaware	3.0	45	Vermont	1.2
13	Alabama	4.4	29	Ohio	3.0	46	New Jersey	0.8
13	Oregon	4.4	29	South Dakota	3.0	47	Maine	0.2
15	Mississippi	4.3	32	Pennsylvania	2.9	47	Massachusetts	0.2
16	Tennessee	4.2	32	South Carolina	2.9	49	New Hampshire	0.0
17	Kentucky	4.1		**United States**	**2.8**	50	Rhode Island	-0.3

The rankings are similar to those for job growth on the preceding page, with Northeastern states and California on the bottom and Western states on top. There are differences, particularly among the top ranked states, because personal income reflects income not captured by the jobs data -- income from farms and other proprietorships, wage and salary changes not caused by job loss and gains (e.g., raises and overtime), and transfer payments such as Social Security benefits.

Farm Economy Prospering

The prosperity of the farm economy is one of the major reasons why states West of the Mississippi River haven't been experiencing the economic problems found in the Northeast. A recent Department of Agriculture report provides the details. Overall the report concludes that the performance of the farm economy "compares favorably with its best performances over the last several decades."

Good times on the farm are good news for state finances. First, there is now little interest in state farm aid programs that were discussed -- and to a limited degree enacted -- in Midwestern states in the mid-1980s. The exception is difficult times being experienced in the dairy industry which have caused state subsidies to be considered in several states and enacted on a limited basis in Vermont. Second, farm prosperity brings high farmland prices and increased business activity in rural areas, improving the base for state and local taxes.

The Department keeps statistics by state on farm equity (value minus debt) and makes calculations on equity per farm and equity per acre. According to these estimates, buying out all the farm operations in the U.S. would take about $700 billion with the largest amounts in Texas ($65 billion), California ($58 billion), and Illinois ($41 billion). The value, net of debt, of the average farm in the U.S. is $326,000. The range is from over $1,000,000 per farm in Arizona and Nevada to $110,000 in West Virginia. By the acre, farms (including equipment as well as land) are worth the most in the Northeast, led by $8,484 in New Jersey. The lowest per-acre values are associated with arid lands in the West with values under $300 an acre in Wyoming, New Mexico, Montana, and Arizona.

Economic Performance And Fiscal Problems

In normal times, the Index of State Economic Momentum is a reasonably good indicator of which states are likely to be experiencing fiscal problems or successes. In recession, this is less true. To find themselves in reasonably good fiscal shape because of a strong economy, states would not only have to exceed national performance but exceed it by a substantial margin. With over 30 states now reporting their current year (FY 1992) budgets out of balance, it isn't surprising to find that some top ranked states in the Index have problems, though by no means as serious as those of states in the bottom ranks.

Among the top ten states, only four -- **Arkansas**, **Idaho**, **Utah**, and **South Dakota** --have stable fiscal policies including paying for about the current levels of state services and state aid for local government, meeting inflation with spending increases, and not making major changes in taxes. **Hawaii** is in equally good shape, but the level of local worry is higher because prosperity appears as a decline when the psychological starting point is a boom.

The other five have problems of their own making. In **Nevada**, the problem is a tax system designed around gambling that is proving inadequate, except in the biggest of economic booms, to handle the service needs of a rapidly growing population. In **Arizona**, the problems are: (1) particularly serious escalation in health costs as the state moves closer to traditional Medicaid programs and (2) budget-balancing decisions in previous years that are now bringing problems. In **Oregon**, the problem is a voter-imposed limit on local property taxes with a mandate that the state make up lost revenue. In **Texas**, the problem is a court decision holding the school finance system unconstitutional. **Nebraska**'s problem also arises from litigation, but over the taxation of personal property.

IMPACTS OF DEFENSE SPENDING CHANGES

Defense Spending Cuts

The disintegration of the Soviet Union and Operation Desert Storm have altered views of the necessary level of defense spending. The disintegration means the perceived #1 threat is less menacing. The success showed the weapons and the readiness and skills of U. S. forces were better relative to the competition than had been assumed. The result is a national consensus that defense spending should be reduced. Changes are already underway, presaging major shifts in the composition as well as the level of spending. They will have significant and differing effects on state economies. State officials are trying to assess these effects and consider what actions, if any, they should be taking.

At a minimum, outlays for defense are likely to be reduced in conformity with the plan submitted by the Bush Administration in early 1991. Inflation-adjusted outlays would drop 20% between 1991 and 1997. Defense spending would continue the decline from 6.4% of gross national product in 1987 to 5.5% in 1990, reaching 3.6% in 1997. Many national leaders are urging a more rapid decline, such as one reflected in economic stimulus legislation that recently passed in the U.S. House of Representatives.

Economic Effects Of The Cuts

The economic effects are obviously dependent upon the size of the cuts and, less obviously, on the characteristics of the reductions. The Administration's reductions have across-the-board effects on all types of forces (strategic and tactical, active and reserve, air, naval, and ground) and on all types of spending (research, weapons buying, pay of personnel). Alternative strategies involve more significant changes, such as a smaller more mobile force, with more spending on some capabilities, such as sea transport, and less on others, such as maintaining Army divisions and Navy carrier groups. Cuts below the Administration's recommended program could take many forms, but appear to be focused primarily on procurement.

Winning And Losing States

A new Congressional Budget Office study of the cuts shows that the overall economic effects depend on how the savings are used. The cuts alone will result in the loss of an estimated 1.1 million jobs in 1995 -- 400,000 in defense jobs in private industry, 200,000 in supplying defense contractors, 360,000 less uniformed military personnel and 130,000 less defense civilian employees. Some states would be more affected than others. In the simulation done by CBO, the most serious negative effects are concentrated in Alaska, Hawaii, Mississippi, Maryland, New Mexico, South Carolina, Virginia, and Washington -- with Connecticut and Kansas close runners-up.

Larger industrial states with heavy defense business -- such as California, Massachusetts, and Missouri -- would suffer lower percentage impacts because their large losses would be mostly offset by large gains in civilian activities. Other states with low reliance on defense, particularly states in the Midwest, would be net gainers depending on the scenario used to measure impact (see Technical Notes).

State Action

Officials of some states are active in efforts in the Congress to make sure defense cuts affect someone else by retaining defense contracts for in-state firms and preventing base closings. Officials of all affected states are involved in assessing the impacts of changes and working with local and defense officials to mitigate clearly identifiable adverse impacts such as those associated with base closings and loss of major orders by defense-oriented firms. Even New Hampshire, which has been more resistant to aiding particular firms and localities for economic development than other states, will pitch in to deal with the effects of an air base closing if the governor's recommendations are adopted.

The impacts on local areas vary tremendously as illustrated in the CBO analysis by special studies of closing Fort Ord (California) and Bath Iron Works (Maine) and loss of much of the substantial defense business in the St. Louis area. The worst problems arise when workers, such as shipyard workers in Maine, aren't likely to be able to find comparable jobs. The least problems arise in diversified economies like St. Louis and in areas like Monterey where the outlook for the private economy is strong.

EVALUATING GOVERNORS AND STATE POLICIES

As the national and state political "high season" nears, the demand for shorthand ways to evaluate the performance of state officials escalates. The already high level of activity becomes a crescendo of gradings, ratings, and supposedly objective assessments.

Standard Comparisons

Comparisons of states are always popular. Many are based on a single measurement such as sales tax rates, welfare payment levels, and per capita income. Twice a year the latest data for these appear in States In Profile. Some comparisons involve complex calculations. Examples are calculating the tax consequences for a hypothetical business opening a plant in each of several states and comparing the regressiveness of tax systems of different states. These comparisons, which are reviewed constantly in **Reports** as they appear, are less well established because they involve expensive work and raise technical issues. But with appropriate caveats, they are widely accepted. That is, accepted in the sense that there is little quarrel about the accuracy of the data. The value judgments -- such as whether it is better to have low or high business taxes -- are clear, though controversial.

Elaborate, But Common, Comparisons

More adventuresome comparisons combine different indicators. Examples are the Index of State Economic Momentum in this issue, comparisons of health using mortality and morbidity data, comparisons of living costs, and comparisons of educational attainment of children in school. All of these reflect judgments about what is how important. In comparing education, should standard tests give equal weight to student's math and verbal scores and no weight to composition? In measuring health, should one premature birth be equated to two suicides, or just one?

All of these composites are flawed in the sense that a second researcher wouldn't necessarily produce the same comparisons as the first, unlike two researchers comparing tax rates who should get the same answers. However, the different answers would arise from disclosed differences in the choice of emphasis -- for example, how much state minimum wage laws affect business location decisions. The competent composite comparisons do pass an important test for any reputable research, being suitable for replication. That is, given the methodology, a second researcher should be able to reproduce the results.

Comparisons Concealing Policy Prescriptions

These comparisons don't tell what many people really want to know: Are taxes too high in California? Is Massachusetts a good place to grow a business, or a family? Is Michigan unfair to the poor, or uncaring about the environment?

To answer questions like these, many comparisons combine comparative statistics with judgments about appropriate policy. Conceptually, this isn't hard. A table comparing welfare payments can become a study of welfare havens or states that neglect the poor, just by renaming the statistics. Using ten statistics rather than one, printing a report with lots of footnotes, and giving the result a catchy title, like the "Green Index," or best-governed states in America, adds to the free-publicity, but doesn't improve the basic concept.

Comparisons Of Elected Officials

Even comparisons of states don't always tell people what they want to know: Does Governor Clinton have a good record in Arkansas? Should my governor be reelected?

Evaluating performance *of a state* is much different from evaluating performance *of state government*. Climate is a perfect illustration. Everyone knows better than to hold state governments responsible for climate as used in studies of the best place to retire. But an annual study of business climate includes many factors nearly as far beyond state government control as the weather. After years of criticism for not recognizing this, that study now distinguishes between factors decided by government and those which are not.

Bad outcomes -- premature births, felonies, welfare dependency -- are the product of many factors, of which state government policy is certainly one. So, arguably, *state officials as a class* could be held accountable. This is much different from evaluating performance of *a particular state official, such as the current governor.* The "Massachusetts Miracle" was a good example of this two step fallacy. The first step was to attribute economic prosperity to state government action. The second was to attribute the state government action to a particular official, Governor Dukakis, who shared power with other officials, like legislators and mayors, for part of the time the presumably good policies were in effect.

Three recent comparisons are indicative of what will be a flood of such activity before November. The first is a magazine article scathing in its review of the "ten worst" economic moves by state and local government. The second is a study identifying "good governors." The third is the "Green Index" showing which states have the best environments and environmental policies.

TEN WORST ECONOMIC MOVES

> *...a series of wrongheaded and shortsighted decisions that could exacerbate the longest recession since the Great Depression of the 1930s. Excessive expenditures have been concealed in complicated footnotes to budget documents, for example, additional taxes have been heaped upon the nation's struggling poor, jobs have been purchased at exorbitant prices, and all-important business growth has been snuffed out by ill-conceived fiscal legislation.*

With this stirring introduction, U.S. News & World Report (1/27) begins an assessment of ten state and local fiscal decisions it considers so wrongheaded that national leaders should examine them to study what *not* to do. While written to show clear error in decisions, the article is based on conclusions by the magazine about appropriate state policies. Those policies (and the primary offenders) are:

Tax Policy: States shouldn't concentrate tax increases on business (Pennsylvania), nor have a corporate income tax rate above 10% (Pennsylvania). They shouldn't tax business services when doing so might cause moves to other states (computer and other services in Pennsylvania, telecommunications in Illinois). States shouldn't raise sales taxes (North Carolina) because they are regressive and provide less dependable revenues than personal income taxes. States exempting food from sales taxes shouldn't define some foods (snack foods in California) as taxable because of administrative costs and difficulty in defining what should be taxed and what shouldn't.

Limiting property taxes (Oregon's 1% initiative) is also a mistake. States shouldn't let local governments require housing developers to cover costs of new schools and other infrastructure. Even when permitted to levy "impact fees," local governments should avoid them, particularly if their housing market is soft (Montgomery County, Maryland).

Financial Management: States shouldn't balance budgets by: (1) selling assets and leasing them back (a prison in New York, a highway in New Jersey), (2) paying bills late (Illinois), (3) accelerating revenues by requiring vendors to remit taxes more quickly (Illinois), (4) delaying scheduled payments to local governments (many states), or (5) adopting Medicaid bootstrap financing plans (Illinois), particularly when they know the federal government is about to disallow the strategy. States shouldn't allow cities to declare bankruptcy and cities (Bridgeport, Connecticut) shouldn't do it. States shouldn't adopt major tax increases and then create an unstable business climate by serious attempts at repealing them (New Jersey), at least not if it looks as though the money is needed.

Economic Development: Government shouldn't buy jobs (Arlington and the State of Texas for GM), particularly not at prices like $69,000 a job (Indiana for United Airlines), and certainly not at $130,000 per job using junk bond financing (Minnesota for Northwest Airlines).

Assessing "Worst" Policies: These assessments of "worst moves" are just opinions with examples. They often implicitly endorse policies their authors wouldn't. For example, rejecting sales and business taxes, as U.S. News does, suggests endorsing higher personal income and property taxes. There are no criteria used to determine which policies are included or excluded from the list of ten, or to determine whether the appropriate list contains ten policies, rather than nine or eleven. The summary assessments lack any appraisal of the arguments for and against the policy, like the complex considerations of the corporate income tax rate decision in Pennsylvania discussed in detail in this issue.

GOOD GOVERNORS

An objective fiscal policy index was devised and used to determine which governors have raised spending and taxes the most and which the least. The results give a clear indication of the fiscal responsibility of each governor.

With these words, CATO Institute's director of fiscal policy studies introduced his 86-page assessment of America's governors. A short version appeared as "The Good Governor Guide" in the Wall Street Journal (2/5). Both versions have precise ratings with school-like letter grades and scores ranging from 25 to 85. These rankings will unquestionably be heavily used by high-ranked governors seeking reelection in November and by opponents of low-ranked governors who are seeking reelection -- "REELECT SMITH -- Ranked As Top Governor by Wall Street Journal."

The rankings seek to distinguish the big spenders and taxers from governors practicing "fiscal restraint." The author says the purpose "is to determine which governors have raised spending the most, and which the least." The rankings are based on the judgment that low spending is good. But, if the methodology and data are sound, the rankings could be reversed to show which governors best meet needs for spending.

The rankings have serious conceptual flaws aggravated by problems in implementing the concepts. Even for those who equate low spending and low taxes with good government, the "Good Governor Guide" isn't a good guide.

Examining The Results: The table selectively illustrates the rankings. Five governors were excluded, so Governors Florio and Waihee tie for the worst possible score.

Some of these rankings "look right" in the sense that they conform to national publicity. Governors Weld, Engler, and Thompson have received national publicity for budget cutting and particularly for attacks on welfare spending. In the Democratic Presidential nomination race, Governor Wilder boasted a no-new-tax stance and Governor Clinton points with pride to a record of spending more to improve schools.

CATO Rankings Of Governors' Fiscal Policies

Rank	Governor	Party	State	Score	Grade
1	Weld	R	Massachusetts	85	A
2	Sullivan	D	Wyoming	75	A
3	Engler	R	Michigan	73	B
5	Wilder	D	Virginia	69	B
6	Bayh	D	Indiana	68	B
10	Romer	D	Colorado	67	B
11	Thompson	R	Wisconsin	64	B
12	McWherter	D	Tennessee	62	B
16	Casey	D	Pennsylvania	58	C-
19	Edgar	R	Illinois	57	C
23	Voinovich	R	Ohio	56	C
25	Schaefer	D	Maryland	55	C
26	Carlson	R	Minnesota	54	C
27	Cuomo	D	New York	54	C
29	Richards	D	Texas	54	C
31	Andrus	D	Idaho	51	D
34	Clinton	D	Arkansas	49	D
36	Branstad	R	Iowa	46	D
42	Wilson	R	California	32	F
43	Weicker	I	Connecticut	27	F
44	Florio	D	New Jersey	25	F
44	Waihee	D	Hawaii	25	F

The tax-raising efforts of Governors Florio and Weicker are well known. Governor Wilson is paired with President Bush by conservative critics as examples of leaders selling out to the tax and spend crowd.

Some of the rankings don't "look right." The #2 governor is one of fewer than ten governors advocating tax increases this year. The #10 governor recently made headlines by confronting the President with the complaint that federal policies were forcing tax increases for his state. Tennessee's #12 governor has been advocating an income tax and recently signed a sales tax increase. Governor Casey places in the top third despite advocating and securing enactment of the nation's largest state tax increase last year. Governor Schaefer (#25) has consistently pushed higher spending and, for the last two years, higher taxes. Governor Branstad (#36) has been fairly consistent in opposing higher taxes.

Besides not totally corresponding to governors' records in advocating higher taxes, the rankings don't correspond to assessments of fiscal management inherent in bond ratings. The three worst states by this measure of fiscal management are Louisiana, whose governor wasn't ranked, New York whose governor is ranked in the middle of the pack, and Massachusetts, whose governor is given the top ranking in the nation.

Evaluating The Study's Methods: As an evaluation of *people* who serve as governor, the study has intrinsic error because the data deal only with the policy decisions and fiscal circumstances of *state governments*. Not recognizing the difference leads to some clear fallacies. By the study's methodology:

Governors get credit for frugality forced on them by legislatures and voters. Governor Sinner gets credit for fiscal restraint because a major tax increase he supported was taken to referendum and rejected by North Dakota voters. Governor Finney gets no blame for recommending what would have been one of the nation's largest tax increases had it not been rejected by the Kansas legislature.

Governors get credit or blame for the actions of their predecessors. Not many current governors came into office with sound fiscal situations bequeathed by their predecessors and their legislators. Exceptions were Governors Walters of Oklahoma (#4), Bayh of Indiana ((#6), Finney of Kansas (#7), and Nelson of Nebraska (#28). They were (although they would dispute this to varying degrees) handed substantial reserve funds, balanced current service spending and taxing patterns, or both. They look good in the CATO rankings.

Some governors who look bad in the rankings were handed the reverse -- low or negative reserves, special unsolved problems like financial institutions in Rhode Island and unbalanced current service budgets -- all exacerbated by recession. Two governors who handed themselves these problems, Casey of Pennsylvania (#16) and McKernan of Maine (#18), look reasonably good in the rankings because CATO gives them credit for good times as well as blame for the bad. Two governors who inherited what everyone in their states saw as a fiscal mess and more or less corrected it, Sundlun of Rhode Island (#39) and Caperton of West Virginia (#40), get bad marks. In the less clear-cut cases of inheriting fiscal problems, three prominent tax-raising governors -- Wilson of California (#42), Weicker of Connecticut (#43), and Florio of New Jersey (#45) -- also contend that they inherited many of the problems causing large tax increases.

Governors get credit or blame for their economic circumstances. The CATO methodology creates interesting results in a booming economy. To the extent that spending follows the economy down or up without tax changes, governors get credit or blame. So Hawaii's boom costs Governor Waihee who ties for last. But New England's contractions help Governor Gregg (#9) despite his association with tax increases.

The problem of crediting governors when state economies falter was noted by Peter Howe who covers Bay State finances for the Boston Globe (2/6). He asked Stephen Moore (CATO) to explain the study's reference to a tax cut of $1,316 for a family of four:

> *Asked over the phone whether Weld had somehow slipped through a huge tax cut last year that no one in the Bay State had noticed, Moore admitted that his $1,316 number represented the decline in total general-fund tax revenues per family during 1991. In other words, when 200,000 people lose their jobs and businesses go bankrupt in record numbers, we should be impressed when the state's total tax take drops.*

The flip side of this problem appeared in Idaho where the booming economy has permitted rapid spending growth with no tax increases. Responding to a grade of D for Governor Andrus, his press secretary gave CATO an F for analysis.

Can This Methodology Be Saved? These problems are inherent in any methodology that ascribes to governors results caused by a state's economy and/or decisions of other political actors. For example, by most techniques of measuring tax burdens, Governor Dukakis gets credit for lowering taxes more than practically any governor in the nation in the mid-1980s. Most other New England governors would also look great. But Oil Patch governors of the 1980s, like Clements of Texas, would appear poor fiscal managers. If spending, not taxes, is the key, then governors take the blame and credit for higher spending associated with rapidly growing and contracting economies. These results are most absurd in the case of Alaska -- excluded "because of peculiarities in its budget and tax policies." The peculiarities are in the CATO measurement, not in the states. They also appear in another resource-rich state, Wyoming, whose governor gets the second highest rank.

These problems would appear in any attempt to do what CATO did, regardless of: (1) who did the work, (2) whether they consider more spending and taxes good or bad, (3) the variables chosen, and (4) how carefully they did the research. CATO's work also has problems of CATO's own making (see Technical Notes). The net effect of conceptual and technical problems is that the ranking doesn't achieve what might be hoped of it. For example, if campaign contributors who want to further a philosophy of cutting state taxes put their money on all the high-ranked governors and no low-ranked ones, they will make what **Reports** would have to call mistakes.

Yesterday's Heroes? What happens to governors ranked tops? David Osborne, whose new book is getting national attention (Issue 4), published Laboratories Of Democracy in 1988 glorifying six governors as a "new breed of governor" who "create models for national growth." Three failed in bids for other office -- Babbitt and Dukakis for the Presidency and Thornburgh the Senate. Governor Blanchard was defeated in his reelection try. The other two -- Governors Clinton and Cuomo -- are still in office.

Scholarly Approaches To Evaluating Governors: There is substantial academic literature on what is known as the "determinants" of state policy. The concept starts with policies to be explained, such as the level of taxes and spending or the extent to which states have liberal social programs as indicated by such measures as welfare payment levels. The research is to find characteristics of the states that are associated statistically with the policies. Some of the relationships are strong, such as the tendency of states with high per capita incomes to spend more per capita. The hard part of the research is to hold these relationships constant and see whether the remaining variation is associated with other factors such as which political party is dominant, how strong the governor's powers are, and features of the population such as age, religion, and attitudes. Individual political actors, such as governors, are never a factor in this type of research.

A recent book, Gubernatorial Leadership And State Policy, explores the state of the art in academic assessments of governors. In its summary chapter, David Gross (University of Kentucky) concludes, "The question of who or what is more powerful or successful, therefore, may simply not have a readily apparent answer that can be considered theoretically satisfying."

THE GREEN INDEX

The Green Index is to the environment what business climate studies are to the economy. The book-length study uses 256 variables to produce an index of "overall environmental health." Oregon ranks first, followed by Maine, Vermont, and California. Southern states have the worst rankings, followed by the Midwest. A subsidiary index uses 179 of the indicators to measure "Green Conditions" which are best in Hawaii and Vermont, and worst in Texas, Indiana, and Louisiana. The other 77 variables assess "Green Policies." The policymakers of California, Oregon, and New Jersey are the winners. Arkansas has the worst policies, followed by Alabama and South Dakota.

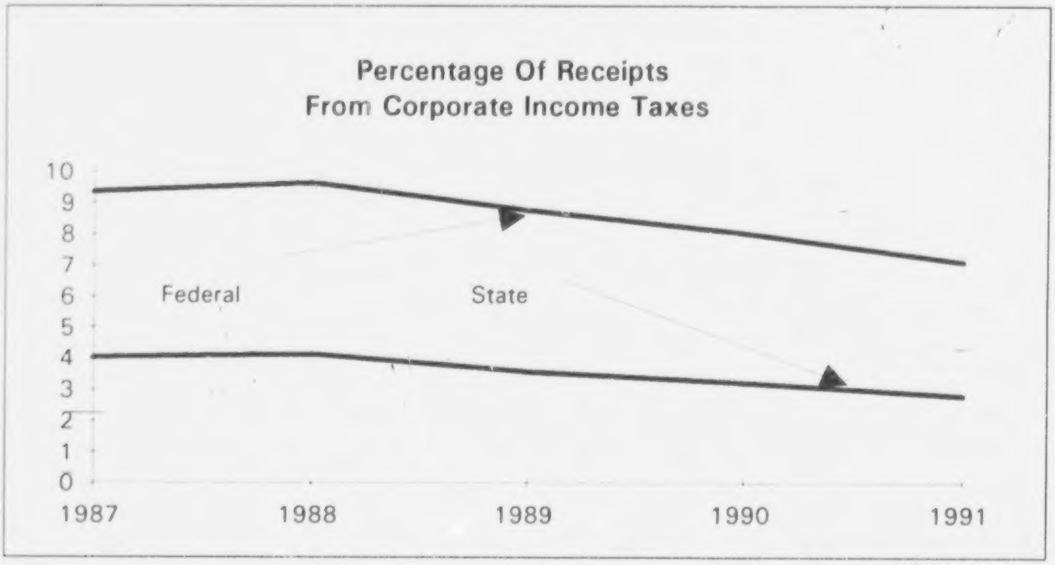
Most of the 179 environmental conditions aren't under control of state officials. For example, states without much water don't have much water pollution. States without much agriculture don't have much agricultural pollution. Some states have more federal land than others. State averages often deal with geography, not people, so pure air in much of Colorado doesn't mean Denver is smog free. A state can improve its "fun and life quality" rank by population loss, but decisionmakers usually don't want to pay this price.

The "green policies" appear to be a reasonably comprehensive listing of state policies backed by most environmentalists. This makes the index useful for some purposes. Although its authors feel as strongly about environmental policies as the CATO author feels about fiscal policies, the study doesn't purport to rank governors, as distinct from state governments.

FAREWELL CORPORATE INCOME TAXES?

Income taxes on corporations appear to be one of the casualties of the economic competition among states, although not all states are pursuing parallel policies.

Taxes on corporate income are becoming an increasingly less important provider of revenues for both federal and state governments as shown below. Corporate income taxes represented about 2.8% of state and local receipts in CY 1991, down from 4% as recently as 1987. Part of the decline is associated with the recession, but it was appearing well before the recession began.



Percentage Of Receipts
From Corporate Income Taxes

State corporate tax collections also have been declining slightly as a percentage of federal ones, with a drop from 28% in 1987 to 27% in 1991. This movement is the opposite of what would be expected as there has been no change in the federal rate during that period while several states have raised their corporate rates. So the percentage should be moving up, not down.

Cutting The Corporate Tax Quietly

These data confirm trends that are apparent in state actions on corporate taxes in the last several years and proposals pending in many legislatures. In difficult fiscal and economic times, there has been little interest in cutting the tax rate paid by corporations but considerable interest in cutting the taxes paid by corporations without cutting the rate. The rationale is that targeted corporate tax breaks will stimulate state economies.

The targets vary. A common one is employment expansion, with credits provided for each job added beyond a baseline. The popular research and development credit works the same way, but the baseline is research and development spending. State investment credits are also common. Some of the targeting is place-specific, such as enterprise zone exemptions. Some is firm-specific, designed as part of a package to lure a particular firm.

Another approach is to reduce the amount of a corporation's income that is attributed to the taxing state. The traditional approach allocates income proportional to percentages of property, sales, and payroll in the taxing state. On this basis, a firm selling internationally from a production base solely in one state would have about two-thirds of its income taxed by that state. By moving to other allocation methods, states have reduced taxes of in-state firms. For example, by allocating income solely on the basis of where sales are made, as Iowa has done, the tax of such a firm would be applied to less than 5% of income not two-thirds. With no rate reduction, this is a 90% tax cut for such a corporation.

Why Cut The Corporate Tax?

There is little evidence that lower corporate income taxes spur state economic development. But many state officials believe that anything that cuts the costs of firms must have some favorable impact on development. There is evidence from surveys of corporate leaders and from testimony of corporate officials in state legislatures that corporate rates provide a psychological signal about state attitudes toward business even though other decisions (e.g., Workers' Compensation, Unemployment Compensation, environmental rules, and property taxes) may have more significant effects on the corporate bottom line.

Corporate income taxes aren't favorites of economists who study tax policy and thus not of legislative staff members who follow their thinking. Picking a public finance textbook at random (Harvey Rosen, Public Finance) yielded a discussion suggesting that who bears the burden of the tax is unknown. It may be workers, not owners, as capital is more able to move among states than labor. The latest book-length state tax study (Robert Ebel, ed., A Fiscal Agenda For Nevada) didn't recommend a particular tax, but seemed no more interested in a corporate income tax than a value added tax or a franchise tax based on corporate worth. It did recommend that any new business tax be applied to corporate and non-corporate business, a criterion which a corporate income tax can't fulfil.

Corporate income taxes are a less reliable source of revenue than other major taxes. Revenues are worst in recession, just when money is needed the most. In the six months ending in December compared to a the same six months a year earlier, the latest report from the Center for the Study of the States shows revenue growth of 6.7% in personal income taxes, 5.7% in all taxes, and 4.9% in sales taxes, but only 0.7% in corporate income taxes despite some rate increases. Revenues are also unpredictable. In the six months, revenues went up by 37% in Arizona, 32% in Oklahoma, and 74% in Rhode Island. They dropped by 71% in Hawaii, 38% in Louisiana, and 47% in Maine.

The Politics Of Corporate Income Taxes

In the politics of state taxation, there has often been a distinction between "liberals" who want tax burdens to fall on business and "conservatives" who favor taxes on individuals. This distinction appears to have blurred in the states and nationally.

The clear thrust of those who are concerned that the rich have too much and the poor too little is to support increasing the top bracket rates of the personal income tax while reducing income taxes on poor persons, avoiding sales taxes, and offsetting sales tax regressiveness with income tax credits. Liberals and conservatives alike are proposing business tax changes such as investment and R&D credits. A noteworthy development occurred this year when the Democratic members of the U. S. House Ways and Means Committee endorsed both: (1) a list of corporate tax breaks and (2) a cut in the corporate rate. Other House Democrats balked at the rate cut, though not at other concessions.

At the state level, action by two states last year brackets the contrasts. Pennsylvania increased its corporate income tax substantially while Connecticut enacted a new personal income tax as part of a package including substantial business tax relief from lowering its corporate income rate. The prevailing approach in states raising taxes was either: (1) raising personal but not business taxes or (2) raising business and personal taxes together approximately maintaining the previous relative reliance on the two.

While those are the types of changes the public is seeing, incremental changes are being made in many states, even in recession, that chip away at the yield of the corporate income tax without changing the apparent rate at which corporations are taxed. In some sense, this gives elected officials the best of two worlds. They conform to public opinion, which clearly favors taxing business over taxing individuals. They simultaneously conform to business pressures for tax reduction and economic development considerations by lowering business taxes. This works, but has risks. One risk is that some business decisionmakers will use the corporate rate, not actual tax burdens, as a measure of state business climate. Another is that actions to reduce business burdens at the expense of taxes directly falling on individuals will be detected and become political issues.

Pennsylvania's Increase In Business Taxes

Last year Pennsylvania raised its corporate income tax rate to 12.25% and applied its sales tax to some business-to-business services. The consequence -- "A Painful Bite For Business" as U.S. News called it (see p. 13) -- was clearly a business concern and arguably the beginning of an exodus of business from the state and unemployment in the affected industries. Pennsylvania was bucking the conventional wisdom by getting a high proportion of its new revenue from business, an action that will be more pronounced if the personal income tax increase is rolled back in July as scheduled.

Its increase in the corporate income tax rate creates a case of a "sore thumb" in state tax policy, to borrow the term used by Urban Institute fiscal expert John Shannon. While Pennsylvania raised its rate, Connecticut lowered its corporate rate, which previously had been the nation's highest. Now the Keystone state has the highest rate in the nation, about twice the median rate which hovers between 6% and 7%. No one knows exactly what impact this will have on economic development, but Shannon argues that "sore thumb" policies have a negative effect as indicators of attitudes of state officials that go beyond the effect of the taxes themselves.

This Pennsylvania decision may be reversed. The state's business community is conducting a major campaign against the new business taxes. The Senate (R-majority) has already passed a measure this year to reduce business taxes including the corporate income rate. The Casey Administration is blaming the result on others as indicated by an OpEd appearing in the Harrisburg Patriot News (2/13) where the state budget director says, "the business community was beaten in the halls of the Legislature by lobbyists from the liquor and tobacco industries. Instead of contributing $300 million to pay for the medical and social programs to alleviate the problems their industries produce, as the governor requested, the tax burden was shifted to business." Rolling back the corporate rate to single digits wouldn't be a new experience for Pennsylvania. The rate was once 11.5% and was gradually whittled down in the 1980s in the name of economic development to 8.5%.

TECHNICAL NOTES

Federal Policy And State Issues: The study of impacts of federal economic stimulus tax proposals is Federation of Tax Administrators (444 North Capitol St. NW, Washington, DC 20001), Impact Of Federal Tax Changes On State Tax Systems.

The National Conference of State Legislatures and the National Governors' Association, through their jointly managed Federal Funds Information For States (400 North Capitol St., NW, Washington, DC 20001), produce detailed and sophisticated analyses of federal budget proposals such as Budget Of The United States Government: Fiscal Year 1993, An FFIS Special Analysis (February). These state groups may now do better at watching grants than federal officials. The FFIS estimates have a footnote indicating the estimates include large amounts (e.g., $1.9 billion in 1993 budget authority) "inadvertently excluded from the President's 1993 Budget grants-in-aid summary table."

State Economic Momentum: The Index of State Economic Momentum, prepared quarterly by **Reports**, measures the *difference* between performance of economies of each state and the nation's performance. It is the average of differences for the latest annual period with statistics available for growth in: population, personal income, and employment.

The national pace is currently slow with a 2.8% growth in income combined with a gain of about 0.76% in population and a loss of 0.76% in employment. Nevada, for example, gets its 2.4 Index by being ahead of the national average by about 1.2% in personal income, 0.5% in employment, and 5% in population growth. The Index and employment changes by state were calculated by **Reports** in more detail than shown, so apparent ties are not ties, but ties in the personal income table represent equal values presented in the Commerce Department data. Farm income statistics come from the Department of Agriculture report, Agricultural Income And Finance (Dec. 1991).

Defense Spending: The Congressional Budget Office study (The Economic Effects Of Reduced Defense Spending, February) concentrates on a scenario that uses the defense savings to reduce the national deficit. This scenario makes the reduction a depressing influence on the national economy through 1995 but a stimulus later through increased private investment and greater exports. A version of this scenario is already built into the models used for forecasting the national economy for use in revenue projections by the federal government and most states. Alternative approaches replace defense spending with immediate consumer spending through tax cuts and/or government spending on public works and other programs. The conventional wisdom is that these approaches are less depressing in the short run, but less stimulative of long-term growth.

Evaluating Governors And State Policies: Stephen Moore's study for the CATO Institute (224 Second St., SE, Washington, DC 20003) is titled A Fiscal Policy Report Card On America's Governors. The three governors elected in 1991 are excluded along with Vermont's newly inaugurated governor and Governor Hickel because Alaskan policies have "peculiarities." Besides the problem of blaming and crediting governors for what they didn't cause, there are technical problems too numerous to cover in detail.

For example, the many governors elected in 1990 and inaugurated in 1991 had their first significant impacts on spending and taxes for FY 1992. There are no reliable data on state and local spending and revenues for FY 1992, which doesn't end until this June. Rather than concede that data won't support assessing these governors, the study assumes that the general fund appropriations were a proxy for future totals. Not true. Some states (e.g., Massachusetts and Michigan) built massive underestimates of spending into their budgets that are now appearing as supplemental budgets. The problems with FY 1992 are even more severe for deficit numbers which come from State Budget & Tax News calculations based on an NCSL survey. SB&TN's assessment (Vol 11, No. 1) in printing them was, "Some of the revenue shortfalls in the table are implausible."

The study uses state spending as a proxy for state and local spending. But some states (e.g., Nebraska) upped their taxes to lower local taxes while others (e.g., Massachusetts) shifted state fiscal problems to local governments. The same problem arises with state personnel counts, ignoring effects when states expand local rather than state employment.

There are also the kinds of errors that would simply be marked wrong in a student paper. One is measuring change in revenue in relation to personal income, which is appropriately done by using information for the same year for each. The study seems to use revenues for different years divided by income for one year, which measures only the revenue change. A harmless, but sloppy error, is measuring tax revenues "per family." This would produce interesting results because some states (e.g., Utah) have substantially more persons per family than others (e.g., West Virginia). These results don't appear because families aren't used except as a construct of four people -- that is, family burdens are per-capita burdens multiplied by four. This is like taking a crowd of 4,000 at a statehouse rally and announcing that 1,000 families were present. The alternative form of presentation doesn't convey added information and is factually incorrect.

The CATO results are so politically potent in some states that there have been attempts to replicate the numbers -- that is, to repeat all the calculations to try to get the same result. The players haven't said anything public yet (and may never), but it would appear that this process is resulting in some admitted problems, which could lead to revisions in the rankings without modifications of the basic concepts.

Gubernatorial Leadership And State Policy (Greenwood Press, 1991) isn't a must read. When translated into English from academic jargon, many of the conclusions are trivial. For example: (1) don't assume a governor is powerful because a large percentage of his legislative program passes if he is just endorsing legislation that would pass anyhow. (2) what a governor can do is limited by his legal authority, and (3) if Republican and Democratic governors act more alike in dealing with Medicaid, party differences in how states handle the program will disappear. The book is full of paragraphs that aren't easy to understand and, once understood, make one wonder whether the understanding was worth the effort. An example is a long passage (p. 85) on the "symmetry of cubes" that leads through inaccurate geometry to the conclusion that "particular attention must be given to the exact shapes of the cubes within which governors define their roles."

The Green Index: The Green Index was developed by staff members of the Institute of Southern Studies and published by Island Press (1718 Connecticut Ave., NW, Washington, DC 20009). It is, at a minimum, a good source of data on subjects like land use, recreation, and the environment. It is well documented with sources and values and ranks for each of the 256 variables.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 7

IN THIS ISSUE

There is little sign of resolution of key tax and spending issues in the large states. The problem is that all the options are unacceptable. Traditional supporters of higher taxes and of sharp spending cuts are more timid than usual. Contrary to popular impressions, federal aid cuts aren't causing the problem and layoffs aren't providing solutions.

- Tough Times, Tough Choices p. 2

The public wants more spending on specific programs, less spending in general, and no tax increases. Americans don't trust elected officials to reconcile these conflicts.

- Public Opinion On State Issues p. 9

Rankings of states in ensuring job safety reflect some federal, not state, decisions and obscure controversial policy choices.

- Safety In The Workplace p. 15

Many state tax issues are in court. The outcomes could increase state revenues in one case, but cut them in the others.

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Federal and state officials share responsibility for delay in attempts to hasten economic recovery by faster spending of highway funds.

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Criticism of state industrial development activities as a "zero-sum game" hasn't discouraged aggressive attempts to lure business.

- Smokestack Chasing Isn't Dead p. 21

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April 1992 (First Of Two April Issues)

TOUGH TIMES, TOUGH CHOICES

Are Budget Decisions Harder This Year?

Every spring, state leaders bemoan the difficulties of reaching agreement on budget and tax issues. Sometimes they say that the difficulties are greater than in previous years. Because such complaints are common, particularly when state treasuries aren't flush with unanticipated revenues, it is hard to conclude that this year is somehow harder than others.

There are indicators that the choices are harder this year -- even harder than last year when nine states were late in adopting budgets, over half raised taxes, and most provided funding for higher education at below current service levels. The fiscal situation is bad for the second legislative session in a row. Legislators face reelection in most states, many in less secure reapportioned districts. Public opinion polls and Presidential primary results indicate a heightened distrust of incumbents. More legislative leaders seem to be complaining about the difficulties in producing a budget they find acceptable.

Extraordinary Problems In The Nine Largest States

Every one of the nine largest states, together accounting for over half the nation's population, faces particularly difficult budget problems this year. As yet, there is little sign of resolution in any of them.

California and **New York** should have acted long ago because their problems include serious FY 1992 shortfalls and because the New York fiscal year starts in April. **Florida** should have been the first of the other states to make decisions because its legislative session ends in April, but it is nowhere near budget decisions. **Illinois** many have the most realistic schedule. It dealt with current year imbalance in a special session, but changed its budget schedule to move the governor's budget submission to April.

Illinois, **Michigan**, and **Ohio** face similar problems. Their governors have strong stands against general tax increases and both Edgar in Illinois and Engler in Michigan are standing against any tax increase. With few exceptions, election-bound legislators of both parties have no interest in tax increases either. Current budgets are out of balance despite the sharp welfare cutbacks in Michigan and Ohio and mid-year corrections in Michigan. Actions to restore balance by further cutbacks this winter are proving inadequate. School equalization issues are pending in all three states. A revolt of property taxpayers is particularly strong in Northern Illinois and Michigan. **Ohio**'s FY 1993 budget, previously enacted as the second year of a biennial budget, is clearly out of balance. **Michigan**'s FY 1993 governor's budget submission is out of balance, though there is disagreement over how badly. On a current service basis, the new **Illinois** budget will be out of balance without sharp spending cuts and/or tax increases.

In **New Jersey** and **Pennsylvania**, the previous large tax increases don't seem to have provided enough to keep the FY 1993 budget in balance assuming all current taxes stay in place. The initiative has been seized by those who want a tax cut this year. In **New Jersey**, the Republican legislative majorities swept into office in late 1991 after the tax increases of 1990 have promised a rollback of the sales tax. In **Pennsylvania**, the governor insists that the personal income tax rate drop, as it is scheduled to do under the tax increase legislation passed in 1991. Proponents of the tax cuts have spending cut proposals that won't be easily accepted. The New Jersey proposal cuts back scheduled school aid increases to promote urban education and satisfy equalization requirements of the state supreme court. The Pennsylvania budget proposal freezes school aid and eliminates the extensive state support of private higher education.

Florida shows signs of repeating last year's chaotic budget battles in Connecticut, with an independent governor vetoing fiscal measures until presented with one conforming to his views. Governor Chiles (I) recommended $1.3 billion in tax increases. He vetoed the more austere budget passed in the regular session. Round Two will be fought at a special session in mid-May. **Texas** is financing schools through next summer with what its supreme court says is an unconstitutional system, right down to its local property tax component. Some taxpayers are in court disputing the concept that a court can decide something is unconstitutional, but not until next year. Legislators are discussing not making a third try at tax increases and school formulas, instead letting the courts devise their own plan.

Inaction In New York And California

> *The legislature, despite the lateness of the hour, has no real sense of urgency. They're having difficulty making even the simplest decisions.*

This late-March lament from Governor Cuomo reflects concerns in both **California** and **New York**, which contain nearly a fifth of the nation's population. Late last year Governors Cuomo and Wilson announced that the FY 1992 budgets were out of balance and urged quick legislative action. Legislative analysts agreed that the problem exists and, particularly in California, suggested it was worse than the governor had indicated. Everyone agreed that the problems infecting the current year would infect FY 1993 as well -- that the problems would cumulate until solved as one year's deficit poisoned the fiscal situation the next year. Everyone knew that tax increases, fee increases, and some expenditure cuts have leadtimes. So action in the spring was necessary to have full-year effects in FY 1993. Winter action was needed to have much impact on FY 1992.

Nothing has happened.

No Place To Go, No Place To Hide

The lack of action is partly caused because state leaders don't know what they want to do. This isn't normally the problem. Usually leaders know what they want to do and delays result from clashes with other leaders with different ideas. This year, many leaders haven't figured out what they want to do. This, rather than conflicting prescriptions of what to do, appears to be contributing to inaction.

John Vasconcellos, who chairs the House Ways and Means Committee in California, described this situation in February comments to the committee:

> *I have no idea how to fix this budget. I have never before not known how to do that in my 12 years as Ways and Means chair.*
>
> *It looks to me like if we raise taxes any more, we are arguably going to hurt the recovery from the recession, which is damaging in the long run. And if we cut services any more, we are going to so destroy people's lives and health and education that there won't be a workforce anymore. It won't be a viable state and a competitive state.*
>
> *It is too easy to do stereotypical left-wing or right-wing slogan solutions that can only exacerbate the state's tragic bankruptcy. That's what worries me the most, especially in an election year.*

Opposition To Budget Compromise Stronger Than Ever

> *I'm not going to let anybody back me into a corner and put a gun to my head.*

Because **Maryland** is on a faster budget schedule than most states, comments like this one are being heard there first. Maryland should have an easier time than many states because the governor and both legislative majorities are of the same party. Unlike California and some other states, extraordinary majorities aren't necessary to adopt budget and tax measures. Despite these advantages, the House speaker had to reverse his own opposition to higher taxes to find a bill that had a chance of getting a House majority. Then he had to issue only his second "leadership call" in six years. The call asks legislators in leadership positions to support a measure or surrender their leadership positions. The quote is from an assistant whip likely to become a backbencher.

Getting a majority for a tight budget containing revenue increases and cuts in current service spending is never easy. A significant group of legislators won't vote for any bill with a tax increase in it. Another group will vote for tax increases, but not if the legislation also cuts spending important to their constituents.

Party discipline may get majorities in Maryland, but can't work in the nine largest states except Texas. None of the others have the same party in control of the governor's office and both houses of the legislature. So each party has what amounts to a veto.

Traditional Positions Have Become Uncomfortable

As leaders search for agreement they are finding unusual difficulties because many legislators are uncomfortable with their own traditional positions on fiscal matters.

The tax-and-spend crowd doesn't want to raise taxes. Legislators, even those most fond of more spending, really don't like raising taxes. This year there are many special arguments against the idea.

First, many tax choices that appear likely both to raise significant money and obtain majority votes are regressive, hitting hard the low income citizens tax-and-spend legislators like to protect. Examples: a gas tax in New York, higher excise taxes on alcohol and tobacco in many states, taxes on snack foods in Maryland, and indirect taxes on utilities.

Second, legislators are sympathetic to the economic argument that they shouldn't be hitting people with tax increases when they are suffering from recession. Rephrased, they buy the argument that when people are tightening their belts, state government should do the same. Third, this is an election year with many legislators facing reapportioned districts and widespread anti-incumbent sentiment.

The cut-the-budget crowd doesn't want to cut spending. In deciding whether to vote for budget cuts, legislators don't get the chance to vote to cut fat, waste, fraud, and abuse. They vote on issues like the amount and distribution of school aid, whether to eliminate recipients or services from Medicaid, and how much to pay employees. The spending cuts available for approval in a yes-or-no vote on a budget package may well not be the ones many anti-tax legislators find acceptable.

Easy cuts aren't enough. The comfort level of cut-the-budget legislators is often highest with cuts affecting welfare cash assistance and state employees -- their number, their pay, and their supplemental benefits. Such have limitations in the budgets of large industrial states, particularly California's.

First, budget cutters already went this route last year. Second, counting on savings involves risk because of: (1) possible federal disapprovals (AFDC payment reductions), (2) state litigation (welfare and employee pension changes) leading to delays, if not disapproval, and (3) inaction such as that affecting layoffs. Third, many legislators whose votes are needed for budget plans with tax increases won't back a bill with big cuts affecting welfare recipients or public employees. So compromise bills requiring decisions won't necessarily have these cuts.

Besides these problems, cuts in these areas won't save enough money in some states. The governor's budget in California already reflects considerable restraint in employee compensation and sharper AFDC cuts than the California legislature would likely accept even in the worst of times. Despite incorporating these cuts and cutbacks in higher education, the California executive budget is badly out of balance.

Other cuts are harder than they look. The spending cuts apparently needed to avoid tax increases require attacking Medicaid and/or local aid, particularly school aid. These choices strike hard at the heart of constituencies of legislators from suburban and rural districts, the (usually but not always Republican) legislators who would be at the center of budget cutting. The details are complex. Because they are complex, some legislators don't understand their constituents' concerns until late in the budget process when they see print-outs of proposed school aid allocations and hear from health care professionals and employers about Medicaid.

> **School Aid For Suburbs**: In California's environment of equalized spending on schools, the basic way that school aid must be cut is by lowering the per pupil spending in the state school aid formula. The net effect is to concentrate the budget cuts on districts the formula defines as middle and upper middle income in terms of ability to support schools with local resources. This is understood by legislators, though not by the press or public It is why Republicans in the Illinois legislature in 1989 wanted a *bigger* tax increase than Democrats did. In New York's school aid the situation is more complex. It involves less school equalization and more making sure not to throw New York City into crisis, but the result is basically the same -- suburban constituencies would be hurt the most.
>
> **Medicaid Protecting Employer Health Plans**: Without a change in Medicaid eligibility, Medicaid is fundamentally two separate problems: nursing homes and all else. In the all else category, a substantial case can be made that costs removed from Medicaid, particularly hospital costs, will remain costs in the health care system but be doubled in price because a 100% in-state cost is substituted for 50-50 cost sharing with the federal government. If this is true, or even partly true, the costs will migrate into employer costs for hospital coverage in their health insurance plans. Fear of this result causes pressures on legislators from health care professionals, hospital administrators, and some business groups to avoid such cost shifting.

Postponement As An Option

With elections approaching and choices difficult, postponing major fiscal decisions obviously has its attractions. Some legislators would rather risk the disapproval of the bond rating agencies than voters. There are already examples of postponement.

After nearly two years of debating enactment of a personal income tax, **Tennessee** legislators have rejected the idea in favor of a half cent increase in the sales tax. The increased spending being financed is ongoing but the 6% tax rate reverts to 5.5% in June of 1993. As a result, taxes will be back on the agenda next year.

After taking the pulse of **Oregon** voters, the governor has decided not to press fiscal reform ideas this year. But a voter initiative has put the state on a schedule of reducing property taxes and replacing the revenue with new state aid that will force reconsideration of the state's tax system -- if not this year then next year.

Putting off fiscal problems by such devices as borrowing from other state funds and from the public, by late payment of bills, and by other available means has been the strategy of choice in **Illinois.**

Postponement has significant opposition in many legislatures, despite its apparent political advantages. Some key groups, such as business leaders and educators, sometimes argue that legislators should face the hard choices. Some legislators, including legislative leaders in many states, are opposed in principle to what they call budget gimmicks.

The Second Massachusetts Miracle?

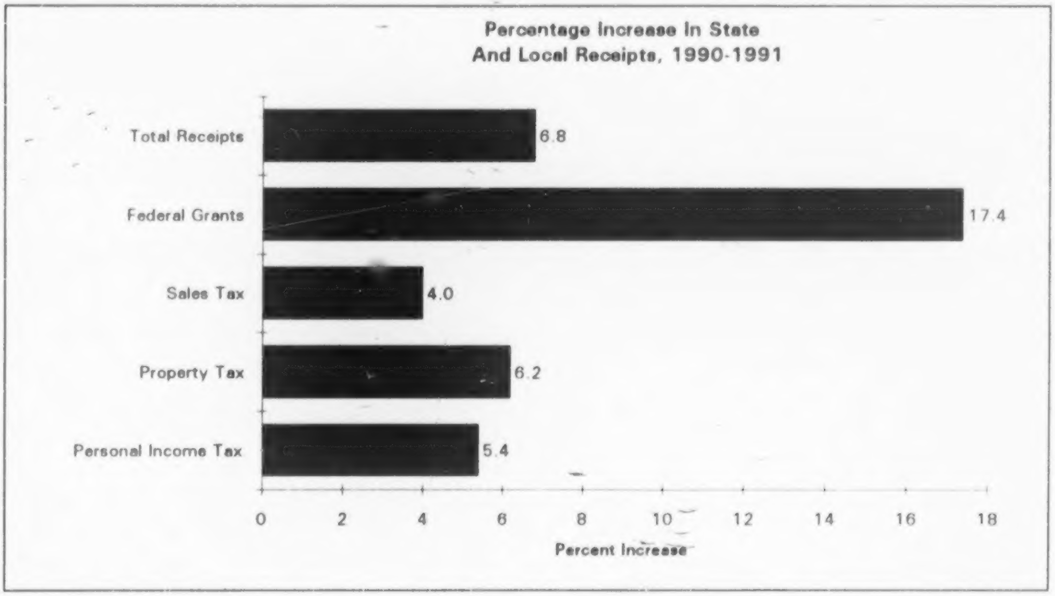
Mixed news on Massachusetts finances continues to flow. The subject is of national interest because the state's fiscal policies and Governor Weld's leadership have been seized by some prominent observers, such as the editorial writers of the Wall Street Journal, as models for other states. The good news includes predictions of FY 1992 tax collections that exceed those underlying the budget by as much as 12%. The bad news is that overestimates of non-tax revenues and underestimates of spending may offset the good news.

The other bad news is that deviations this large from budget estimates don't inspire confidence in financial management. Moody's and Standard and Poor's reassessed their Bay State bond ratings in March, concluding that the state should retain the lowest rating in the nation. S&P did put the state on its CreditWatch list of possible rating changes, indicating an upgrade might be considered when the FY 1992 results and FY 1993 decisions are known.

The fear, as described in a five-page analysis in State Budget & Tax News (2/20), is the simultaneous success of two policies. The opponents of spending cuts could prevail by a combination of legislative inaction, court decisions, executive branch reversals, and unanticipated adverse circumstances. The governor and other proponents of tax cuts -- including a key one that is scheduled under current law -- could prevail in reducing revenue. The governor doesn't appear to be bucking tax cuts not in his plan, such as an estate tax cut he says he would sign. Legislators aren't likely to block cuts scheduled under current law and may support business tax cuts proposed by the governor.

Declining Federal Aid Or The Federal Fix?

The chart below dramatically shows that cutbacks in federal aid have *not* contributed to current state and local fiscal problems. Rather than causing those problems, federal aid has been rising at twice the rate state and local governments have been tapping their own revenue sources.



The data reflect state and local revenues in the last quarter of 1991 (seasonally adjusted at annual rates) compared with the same quarter a year earlier.

State fiscal problems can't be explained as a lack of federal money. The federal causes are more complex -- including mandates, federal judicial pressures on spending, and lack of growth in several key programs. The sharp federal aid growth is itself a mixed blessing. The increases are driven primarily by AFDC and Medicaid. The same factors producing double digit increases in federal aid for them drive rapid state spending growth.

Widespread Layoffs Not Solving Problems

Widespread layoffs of state employees aren't being used as budget strategies. There has been considerable publicity about cutting state payrolls and layoffs, but most of it has been about what might happen. Some layoffs have been announced, but not implemented. The result is a series of assessments contrasting promise and performance such as "Pink Slips For Paper Jobs" (City & State, 3/9) and "The Shrink-Proof Bureaucracy" (Governing, March).

A major source of state fiscal problems has been expanding workload -- more prisoners to guard, more parolees to supervise, more child abuse cases to investigate, more children to monitor in state-supervised settings, more AFDC recipients to monitor and pay, and more Medicaid claims to review. With no sentiment to change ratios of front-line workers to workload (e.g., prisoners per guard, abuse claims to investigators), state staffing would be expected to increase, not decrease. In other state labor-intensive activities (e.g., highway maintenance and tax collection), there hasn't been strong sentiment for cutting jobs. In overhead and administrative functions, where sentiment to cut jobs is strong, there are many fewer jobs. So net employment cuts are hard to realize.

Impressive job reductions can be obtained in a few areas, but generally involve shifting jobs from the state payroll to a local or private payroll, not necessarily net savings. Examples are closing state mental institutions and replacing them with purchased care in private and community programs, selling state liquor stores, and contracting for functions like data processing, janitorial services, and food service in state institutions.

PUBLIC OPINION ON STATE ISSUES

Polls indicate it. Pundits pontificate about it. Politicians perceive it.

It *is the mood of the public, and it is foul.*

This assessment in Changes In The Legislatures begins a discussion of term limits-- "the single biggest change facing legislatures in the coming decade." *De facto* one-term limits for governors imposed by angry voters are the subject of a recent Neal Peirce column (3/29) with the catchy title, "Governors And Voters: Hard Times And Hard Feelings."

Elected officials have many reasons to feel besieged -- scandals affecting the Congress and some legislatures, media attacks, the term limit movement, and more. In this context, the news about public opinion in this article is all bad. The public clearly prefers that legislators do what their professional staffs say can't be done -- find ways to tax less and spend more.

Term Limits Get Green Light

In March, the U.S. Supreme Court declined to consider challenges to Proposition 140, the California measure limiting legislative terms and reducing the size of legislative staffs. The decision, which lets stand the California courts' approval of the measure, means all legal challenges have been exhausted. California legislators are now considering going back to voters to attempt to salvage their legislative fiscal and auditing staffs. Two other states have passed limits. At least three more will have them on the ballot this year.

One reason for the difficulties that governors and legislators are experiencing with state budgets this year is the chasm between what the public supports and what appears to be necessary. Legislators are resisting leadership calls, like the one in Maryland, for what seem to them to be good reasons. They are being asked to violate the apparent wishes of their constituents, to violate their own often sincere campaign promises, to offend many of their contributors, and to provide ammunition to their opponents. This is not fun, not psychologically rewarding, and not likely a good move to further a career as an elected official.

One solution not likely to be palatable to many elected officials is to create an army of expendable volunteers who will successfully run for office, "do the right thing," and then retire to some other line of work. This is essentially what Governor Chiles asked Florida legislators to do. It is also the prescription of state fiscal expert Steven Gold, as quoted in the conclusion of Neal Peirce's column on the unpopularity of governors:

> *We need more people who don't care about being reelected who'll do the right thing for their states. Otherwise, the states won't bite the bullet.*

Public opinion doesn't have to be rigorous, and generally isn't. A major problem in interpreting the type of polling data presented in this article arises from the assumption that there will be some rigor in the results. There often isn't.

Opinion poll results are highly sensitive to how questions are presented. For example, a recent Illinois comparison of program popularity ranked spending for *prisons* lower than spending for *low income families*. Changing *prisons* to *keeping criminals off the streets* would have improved the ranking considerably. Changing *low income families* to *welfare* or *welfare recipients* would have reduced the score, but changing to *needy children* would improve the score.

Answers indicating that respondents are willing to pay more taxes for some public function like education have several problems. One is that the amounts being considered by respondents are often considerably less than the costs of policies the survey readers have in mind. A second is that attacks on incumbents by challengers don't take the same form as the polls. The attack is INCUMBENT RAISED TAXES, not INCUMBENT RAISED TAXES FOR SCHOOLS. Attacks don't need to be logical, just effective. But if logic is required, it is that the incumbent should have provided the money for schools out of existing low priority programs, rather than raising taxes.

Voters' views on taxes and spending are notoriously dependent upon whether a change in policy is involved. Voter support for federal tax cuts is relatively soft, and initiatives to repeal existing taxes generally fail at the state level. But voter opposition to tax increases is generally high. Measures to raise state taxes, like the Missouri 1991 one, often lose by wide margins.

Tax And Spending Choices

An exit poll after the primary voting in Michigan in March provided a somewhat surprising preference for economic stimulus measures over tax cuts. Of course, voters in a Democratic Presidential primary aren't representative of Michigan voters and Michigan voters aren't necessarily representative of voters elsewhere. The question was, "Which should be a higher priority: -- Providing incentives for economic growth or a tax cut for the middle class? Sixty-two percent picked the incentives while 35% opted for the tax cut, with the rest not knowing. The same question in the Illinois exit poll produced a 60-36% margin for the growth incentives.

Another poll shows that interest in a national middle class tax cut depends heavily on how the question is phrased, a result that probably would be obtained from asking similar questions about state tax cuts. When a national sample of voters was asked if they favored or opposed "cutting taxes enough to save most Americans up to $400 a year," 65% said yes while 27% declined the offer. The second formulation was, "Some people say the federal government should cut taxes enough to save most Americans up to $400 a year. Others say such a tax cut is too small to stimulate the economy and would increase the large federal budget deficit. Do you favor or oppose such a tax cut plan?" Support was 47% with 42% opposition.

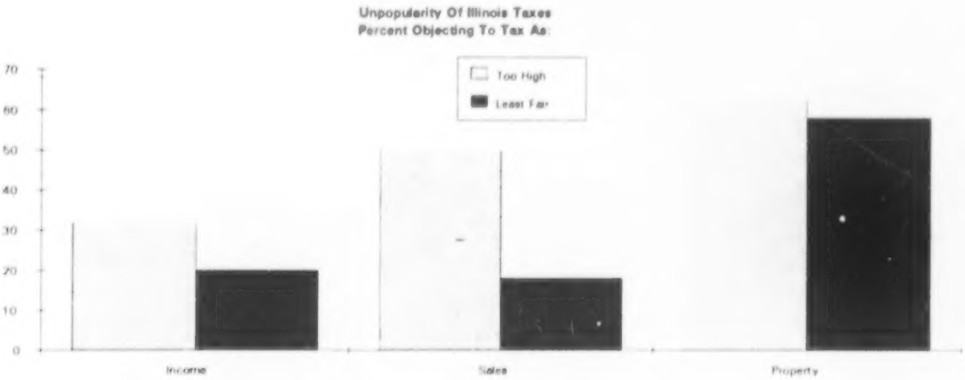
An annual Illinois poll confirms common patterns of voter preferences, particularly the dual preference for higher spending and lower taxes. Higher state spending for public schools appeals to 77% of the voters, followed by 62% for job training and medical care, 54% for higher education, 52% for the environment, 48% for low income families, 35% for economic development, 32% for prisons, and 25% for roads.

A Montana poll asked which spending people would be willing to pay higher taxes to support "if spending cuts alone won't balance the budget." Elementary and secondary education got 73% support followed by 69% for vocational and technical education, 59% for higher education, 56% for social programs and public assistance, and 50% for state institutions such as the state mental hospital and prisons. As found in other surveys, the support for school spending is weakest among those over 65 and strongest among those under 35 and college graduates.

Property Taxes Least Popular

The Montana poll asked for the preferred method of raising revenue and gave choices of adopting a sales tax (which Montana does not have), increasing income taxes, and increasing property taxes. Four percent rejected the question, saying spending should be cut. The sales tax drew 42% support, followed by the income tax at 22%, and the property tax at 8%.

The graph shows the relative unpopularity of the three major sources of revenue in Illinois. Property taxes are more likely than the other two to be considered too high and more unfair. Dissatisfaction with the income tax is probably lower in Illinois than some other income tax states because there is no local tax and the state tax is levied at a low flat rate on a broad base. The property tax in Illinois is probably less popular because Cook County has a unique system of rolling quadrennial assessments. The resulting differing interactions of tax rates and reevaluations are considered unfair and arbitrary by those who don't understand the system and by the handful of people who do.



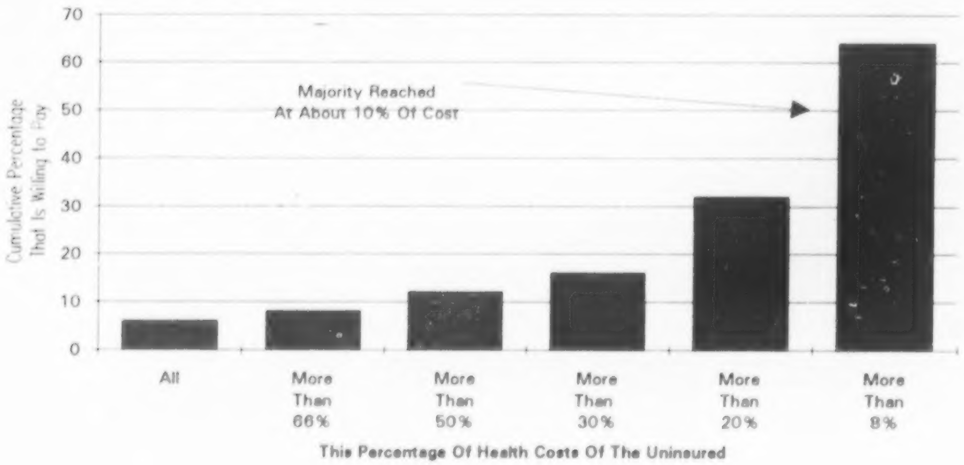
Health Care Should Be Provided At A Tenth The Price

Sixty percent of Americans believe there is a need for major reform of the nation's health care system. Over 70% agree with the statement, "Changing our health care system would cost everyone more money either in higher taxes or higher personal health care costs." The majority of Americans don't know what the Medicaid program is. Given brief descriptions of five radically different national health plans, ranging from a government-run system to a totally private one with tax credits, a majority of respondents favored each of these inconsistent plans.

Health care reform isn't important personally for 52% who say their personal health care situation is satisfactory and another 10% saying only minor changes are needed. Two-thirds are confident they have adequate insurance to meet the cost of a major medical expense. The satisfaction with health care and health insurance coverage among those under 65 rises to 78% when only persons with private health insurance are considered. Dissatisfaction, and support for health care reform, is highest among those of low incomes and those without insurance. So support for change is lowest in the groups with the highest voter turnout -- those over 65 and employed, higher income persons.

There is considerable support for considering health care as a right. However, when asked to consider the costs of making it a right through government-sponsored plans, the public balks. The graph below was constructed (see Technical Notes) from public opinion data to show the feasibility of a government-sponsored health plan covering the uninsured. The concept enjoys broad support with two-thirds of those surveyed willing to pay something for it. But what they would be willing to pay doesn't approximate the cost of doing what they favor. Less than 10% say they are willing to pay all the costs. To get a plan that would cover all the uninsured would cost about $600 a year for every adult in America. To get a price for a plan that is acceptable to a majority, the price needs to be around $60 a year for every adult.

Majority Supports Health For Uninsured
Only At Ten Cents For A Dollar



School Spending Should Be Equalized Up

A recent Kansas poll indicates endorsement of substantial school finance equalization and a statewide property tax by 61% of the electorate, with 27% rejecting the idea. These results are probably a better indicator of the limitations of such polls than of support for particular school financing concepts. The exact question was:

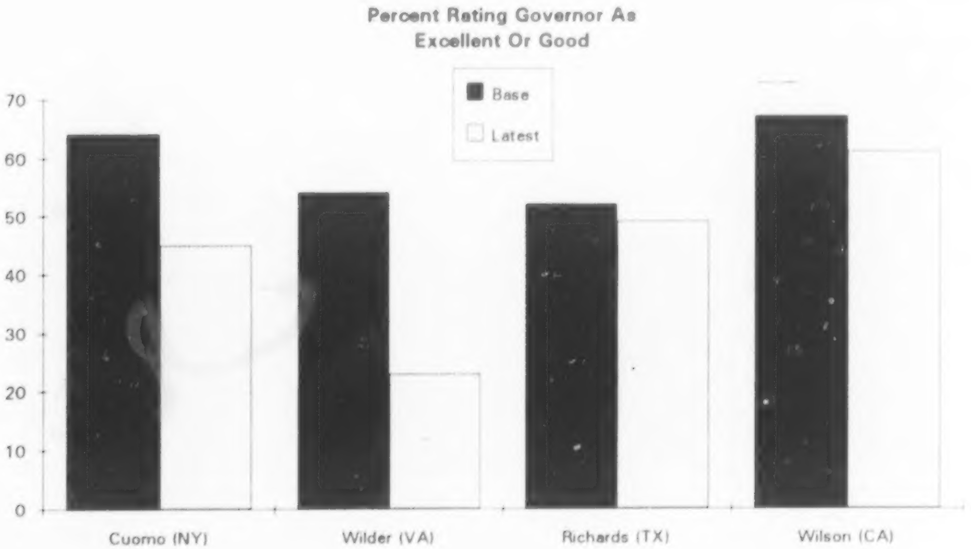
> *Per-student spending varies widely by school district. Some argue that this creates unfair educational opportunities because students in poorer districts do not have as much money spent on them as students in richer districts. Do you think the state should set the same property tax statewide and require that each district spend roughly the same amount per student?*

Responses to the follow-up question indicated that about half of respondents would abandon their support if the new approach raised their property taxes or reduced what their local schools had to spend. Any new school finance program will have precisely this result unless: (1) the state kicks in new money or (2) the voter lives in a district with exactly the average tax base per pupil *and* a tax rate equal to the new local effort requirement.

Elected Officials Are Doing A Poor Job

Public disenchantment with government officials in general and legislatures in particular seems to be rising. For a good summary, see Alan Ehrenhalt's article "An Embattled Institution" in Governing (January). Sample line: "For America's legislatures, 1991 was a year only a cynic could love."

At both the national and state level, approval ratings for legislatures tend to be lower than those for chief executives. Rankings of chief executives have been dropping as shown in the chart. It compares ratings of doing a good or excellent job between surveys taken in late 1990 and 1991 and surveys taken more recently.



Governors and legislators are swept by the tides affecting how the public perceives authority figures generally, by well-publicized ethics problems, and by association with the national and state economic problems. This year state officials are in the public eye bringing bad news, like tax increases, and arguing among themselves over what additional bad news to bring -- publicity not destined to make them popular.

Fighting Back In Oklahoma

The conventional wisdom is that elected officials shouldn't pick fights with anyone who buys ink by the ton. This made Governor Walters' state-of-the-state address one of the more unusual events in the early months of state legislative sessions. The governor used more than half of his speech to criticize media coverage of him and his family.

He has lots to complain about. Through much of 1991, the big news in Oklahoma was a federal investigation, later dropped, of an allegation that he offered campaign workers future jobs in exchange for contributions. In November, his 19-year-old son was charged with the misdemeanor of possessing drug paraphernalia after pipes commonly used for smoking marijuana were found in his apartment. The police sought to build a drug possession case by sprouting some of the seeds found, keeping the local media informed daily on progress. The seeds turned out not to be marijuana, but not until after what the boy's mother counted as 47 TV news stories in a single week. He pleaded no contest to the paraphernalia charge, though saying the pipes belonged to a friend. In mid-December he committed suicide, an action to which the parents believe press contributed, if not caused.

The governor concluded, "The two most important things to me, my family and my integrity, have been virtually destroyed." Afterwards, he commented that if his son's death leads to more fairness in treatment of elected officials by the media it will have contributed something. His concerns attracted media attention and some editorial support, such as a characterization by Forbes (3/30) of the coverage of the son as a "media wolf-pack attack."

SAFETY IN THE WORKPLACE

What the data clearly show is that state decisionmakers ... have a large influence over the forces that shape job health.

This is the premise of a new set of state rankings of occupational health and safety programs. Like just about any ranking of states, it was widely covered by the media, particularly in the low ranked states. Interest was heightened by the fact that Arkansas was ranked last. Release of the study shortly after a plant fire in North Carolina that killed 25 workers, the most fatalities in an industrial setting in at least five years, also added interest. The Arkansas Democrat Gazette (1/1) headlined, "Study Ranks Arkansas Last In Job Safety." Governing (March) printed the rankings.

In concept, these rankings don't make sense as evaluations of state policy. The cutting edge of policies to prevent workplace accidents is *federal* Occupational Safety and Health (OSHA) legislation which preempts the field. The major state issue is whether to assume responsibility for administration. Some states do. Some don't.

Should States Administer OSHA Programs?

States have the option of administering their own programs subject to federal guidelines and supervision, which 21 states do. Or, they can let federal officials take full responsibility, which 29 states do.

Which is the best approach for ensuring worker safety? There are strong arguments on both sides. The answer isn't necessarily the same in every state. It partly depends on how individual states would administer the program relative to federal administration. Over the years, organized labor and organized business have been on both sides of the issue, suggesting pro-labor and pro-business positions aren't obvious.

Federal Is Better, North Carolina: After the Hamlet, North Carolina disaster, there was a widespread presumption that the problem arose because North Carolina was one of the states that opted to administer the program. Shortly after the accident, federal officials announced that they were asserting concurrent jurisdiction with the state. This action makes sense if it is assumed that state administration in general, or at least North Carolina's, is less effective than federal.

State Is Better, California: The reverse presumption has permeated treatment of the issue in California. California administered the law until 1987, when Governor Deukmejian (R) vetoed funding for state administration and the legislature (D-led) failed to override the veto. This put California in default of its agreement to administer the federal law, so the federal government was forced to take over. The rationale for the governor's action was saving money -- getting enforcement free from the federal government rather than sharing costs 50-50. It was widely believed that the move was pro-business, anti-labor as well, designed to relieve unnecessary regulatory burdens at a minimum and at maximum to improve California's business climate at the expense of worker safety. Organized labor used the initiative process to take the issue to California voters, who approved resumption of state responsibility in a November 1988 vote. California was recertified and resumed state administration in 1989.

No Clear Answer, Most States: There are clear patterns among states in labor law. Some states have labor-favored policies like little Davis-Bacon acts, collective bargaining for public employees, higher minimum wages than the federal level, high Unemployment Compensation and Workers' Compensation maximum payments, liberal eligibility for WC and UC, and no right-to-work laws. These policies are highly correlated -- a state with one is likely to have others. Taking control of OSHA administration doesn't fit this pattern. Some states with labor-favored policies run their own program -- Hawaii and Michigan, for example. Other states with labor-favored policies -- Massachusetts and Rhode Island -- let the federal government handle it. On the other side, Indiana, the Carolinas, and Utah run their own programs, but Alabama, Arkansas, North Dakota, and Texas rely on federal enforcement.

Wrong Rankings For Wrong Reasons

Ranking States For Federal Decisions: How can one compare OSHA activities of 50 states if 29 programs are run by one federal government? One defensible choice would be to decide whether federal or state administration was the right decision and award lots of points to the states making that decision. The study doesn't do this. Instead, it compares federal policies with federal policies and attributes the differences to states. For example, the mean federal fine for Maine employers has been $5,360, twice that of the next highest state (Texas, $2,150), four times the average ($1,260) and well above other states with federal administration like Arkansas, Kansas, and Louisiana -- all under $700. Maine gets ranking points for this.

Other Problems With The Rankings: The study has other anomalies. A major factor in the rankings is how many different medical conditions are "reportable occupational diseases." States vary all over the lot. Wyoming has none. Rhode Island has one. California has three. Most states have six or less. Michigan has 34, 49 if one counts separately all the types of poisoning listed in the report. More is better, according to the rankings.

Yet another factor is whether workers who come to work drunk and are injured get less compensation because of their contributory negligence. The original concept of Workers' Compensation was to deny this defense to employers, but it is now allowed in some states. Points are awarded for denying the defense.

Conclusion -- These Rankings Aren't Safe: The problem with these rankings isn't that they are biased. Neither ~~business~~ nor labor seem to have left any footprints in the acknowledgements or in the disclosures of financial support, which comes from foundations. The problem is that they don't make sense. If a state cut its workplace injury rate in half and another, by malicious policies, tripled its industrial accident rate, *neither state's ranking would change.*

LEGAL CHALLENGES TO STATE TAXES

Taxing Multistate Corporations: Considerable litigation is pending in many judicial forums on the question of how far states can reach to tax income generated in other states and nations. The law is settled that a state can consider a single corporation with a single business as an entity, regardless of where its income is actually earned. For example, Idaho can tax the income of the XYZ Company by allocating a portion of its nationwide income to Idaho based on factors such as the percentage of sales, payroll, and property in Idaho. Idaho doesn't have to listen to company arguments that its sales in Idaho were less profitable than in other states or that its Idaho plant is less profitable than its Georgia plant.

These issues are more exciting when the business is legally more than one company, such as XYZ Manufacturing based in Idaho, XYZ Franchise Operations, Inc., with no operations in Idaho, XYZ Overseas based in Portugal, and XYZ Holdings based in New York, which holds stock in the other companies. One sticky issue is whether states get to tax XYZ Holding's "passive earnings," such as interest on short-term investments. In March, the U.S. Supreme Court took the unusual step of broadening a case in which New Jersey and Allied-Signal are arguing over $1.8 million. Acting as though it wants to consider remaking policy on a broad front, it asked the parties to present arguments on whether earlier decisions on the subject should be overturned and, if so, what doctrines should replace them. It also invited third parties to present arguments.

Mail Order Sales: In January, the U.S. Supreme Court heard oral argument in the case pitting North Dakota against Quill Corporation, a major mail-order purveyor of office supplies. Quill has substantial in-state sales, but minimal presence there. Quill contends that under the 1967 *Bellas Hess* case, the state can't force it to collect sales tax. The state wants *Bellas Hess* overruled. The stakes are substantial, as much as $4 billion a year in state and local income nationwide. One tough issue, raised in oral argument, is the extent to which states would raise even more revenue by retroactive liability.

Even if they lose in court, states might be able to get Congress to pass a law expressly consenting to the state taxation. This would remove any objections to the state action as unconstitutional under the Commerce Clause. That legislation hasn't gone anywhere. Mail order companies oppose it, which isn't a fatal problem as long as there are offsetting voices from their taxpaying local competitors. But state and local officials are unable to agree on what they want Congress to pass. The dispute is over how to figure and disburse local sales taxes without making vendors figure them out for each sale.

While the issue is being litigated, more states are seeking to tax mail order sales. Indiana's new statute, like many others, extends liability well beyond *Bellas Hess*. At a minimum, this increases litigation costs and risks of retroactive liability for mail order companies. At maximum, it will force some to collect the tax.

Property Tax Discrimination: In February, the U.S. Supreme Court heard arguments in a case challenging the aspect of California's Proposition 13 that causes properties of equal value to have unequal assessments and thus unequal taxes. The result follows from applying current-value assessment to properties changing hands while capping valuation increases for other property. The resulting discrimination arguably violates the equal protection of the laws guaranteed by the Fourteenth Amendment. In a 1989 case involving assessments in West Virginia, the Court found unconstitutional discrimination.

Discrimination Against Interstate Commerce: The Supreme Court has agreed to review a challenge to Alabama's differential treatment of hazardous waste from in-state and out-of-state sources.

The Court will also hear claims by three New England states that New Hampshire's complex method of taxing the Seabrook nuclear reactor discriminates against commerce. They charge that New Hampshire is making power consumers in other states pay while shielding its residents. The issues weren't complex in Wyoming's case that Oklahoma was discriminating against commerce by requiring that in-state utilities burn local coal. The Court summarily rejected the Oklahoma law.

Retroactive Refund Liability: Many claims for retroactive refunds under the 1989 *Davis* holding (states cannot tax federal pension income while exempting state and local pensions) are still in litigation. Virginia is the state most at risk from an adverse holding.

ACCELERATED HIGHWAY SPENDING

> *There is plenty of money in the pipeline. It's that the spigot is not working.*

This is how U.S. Transportation Secretary Andrew Card described the failure of most states to move rapidly to put highway work under contract in order to help recover from recession. While 20% more federal highway funds have been obligated than last year at this time, he says the pace should be considerably faster.

Most state and federal economic stimulus packages are just talk so far. Proposals for new federal aid to accelerate public works are pending in the Congress where they may not pass and certainly won't be enacted quickly. Many state proposals require legislative, and often voter, bond-issue approvals that haven't been forthcoming so far. Many governors have talked of accelerating construction using funds already available, but some states are doing much better than others as shown by the table on p. 20.

Part of the problem was delayed passage of federal highway legislation. Last October, state transportation secretaries warned that delay had caused many states to put a hold on new projects and that lost ground might not be fully recovered. However, the mechanisms for accelerating spending are now in place. The U.S. Department of Transportation has cleared away federal hurdles to permit use of available highway funds with contracts let this spring.

Last year's highway legislation lets the states skip the matching fund requirements, provided only that they find the matching funds within two years. Only four states -- Alaska, Maryland, North Dakota, and Vermont -- are using this flexibility. A survey of state transportation officials in January indicated that only six states are likely to use it in FY 1992 and seven in FY 1993.

Percentage Of Available FY 1992 Federal Highway Funds Used, March 2, 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	72.6%	18	South Dakota	35.8%	34	Idaho	25.4%
2	Colorado	70.0	19	Missouri	35.6	35	South Carolina	23.8
3	Iowa	57.7	20	Montana	33.4	36	North Carolina	23.2
4	Wyoming	56.9	21	Texas	33.4	37	Kentucky	23.0
5	Louisiana	54.6	22	Maryland	33.1	38	Washington	22.6
6	North Dakota	54.2		**United States**	**32.3**	39	Alaska	19.2
7	Wisconsin	53.8	23	Delaware	31.3	40	Utah	17.4
8	Pennsylvania	50.0	24	Nevada	30.6	41	New Jersey	16.3
9	Oklahoma	46.4	25	Florida	30.2	42	New Hampshire	15.6
10	Massachusetts	45.7	26	Virginia	29.8	43	Ohio	14.8
11	Arkansas	45.6	27	Arizona	29.3	44	Vermont	12.8
12	Mississippi	45.6	28	Michigan	28.6	45	Alabama	11.8
13	New Mexico	44.7	29	Maine	27.9	46	Kansas	11.5
14	Indiana	44.2	30	Georgia	27.8	47	Hawaii	8.5
15	Tennessee	37.2	31	Oregon	27.5	48	Connecticut	8.4
16	Minnesota	36.8	32	New York	26.8	49	Rhode Island	7.6
17	California	36.1	33	Illinois	26.4	50	West Virginia	7.6

With the federal FY 1992 about half over, only about a third of the highway money has been committed. This isn't surprising because the peak contract-letting season is in the spring for construction to be performed in the warmer months. But winter weather didn't keep cold-winter states like Colorado and Wyoming from leading the list and doesn't explain Hawaii's or Alabama's low rank. The rankings indicate no geographic, economic, or political pattern. Among the depressed New England states, Massachusetts ranks tenth but Connecticut, New Hampshire, and Rhode Island are in the bottom ten. Two of the states with top-performing economies, Arkansas and Nebraska, are among the fastest dozen states. States with low-tax, low-spend governors are on the top and bottom of the list.

In some states, there is reluctance to accelerate contracting without matching funds in sight. Temporarily borrowing the match from the federal line of credit apparently seems too adventuresome for some state officials because they would have to cut back spending later to make up the match. Some officials are seeking additional money from their legislatures, the explanation for Alabama's slow response. Some legislatures and governors probably haven't pushed their highway agencies to accelerate construction.

In a recent speech, Secretary Card urged county officials to light fires under the state agencies in the lagging states. By releasing the comparisons, he lit a few fires himself. The timing couldn't have been worse than in Michigan and New York. While Card was releasing figures showing they lagged behind the national average, their governors were pushing new bond-funded infrastructure proposals as economy-stimulating measures.

There is plenty of blame to go around on the question of accelerating highway projects. In January, North Carolina's Governor Martin complained that many highway projects were being delayed by "unnecessary stagnation" in federal permit processes. He estimated that $83 million worth of North Carolina projects and billions nationally were unnecessarily tied up in the processes. He suggested methods, such as use of arbitrators for minor disputes, to speed them up.

The Congress is also to be blamed for the interaction of a decision on a Brooklyn courthouse and the highway program that has tied up federal matching money. Senator Moynihan (NY) who sponsored the courthouse legislation calls it a "Kafka-esque situation."

SMOKESTACK CHASING ISN'T DEAD

Introduction: "Smokestack chasing" is the pejorative phrase used to refer to aggressive attempts by state and local governments to draw jobs by relocation from other areas and by obtaining new plant investments. It has no rigid definition, but is typically applied to the work done by industrial developers as they identity prospects and present the merits of their local areas. The alternative is said to be avoiding ruinous industrial development competition while favoring strategies oriented toward education and infrastructure. The usual state response to these types of second and third waves of development thinking has been to adopt them, *without reducing efforts at traditional industrial development.*

Competition Stiff: The immense state and local costs associated with the United Airlines maintenance base, the Northwest Airlines deal, the McDonnell Douglas bidding, and the supercollider suggest that the competition in pure smokestack chasing is becoming stiffer, not more relaxed. Neal Peirce concludes in his syndicated column (12/22), "Never have the sums been so colossal; nor, the perils to the taxpayers so great." He quotes a business location consultant:

> *Every governor and mayor elected in the last four years has promised new jobs and development and hasn't been able to deliver. They're caught between a rock and a hard place. They have to bid on the jobs.*

Smokestack Chasing, Mississippi Style: In most chronicles of industrial development, Mississippi is given credit for originating and popularizing the concepts of having teams of developers visit officials of manufacturing companies and offering tax abatements for new facilities. More recently, the state has been used as an example of shifting from traditional concepts to new waves of development ideas.

The new governor, Kirk Fordice, won last November on a platform that included strong opposition to new taxes and added state spending. So far, he has continued that approach despite arguments that education is seriously underfunded. He concedes that improving education is a key to development, but says the state doesn't have the "luxury" of waiting for results: "It takes 10 to 12 years of concerted effort to make a noticeable difference in an education system. We obviously don't have 10-12 years to wait on jobs."

He has pledged to devote substantial portions of his own time to talking "CEO to CEO" to top executives of companies that might locate facilities in Mississippi. He also wants the latest tools in development recruiting:

> *The prospect comes in, states his requirements. You plug them in and do a printout and say, "These are the communities that fulfill your requirements. There's a helicopter outside. Which one do you want to look at first?" That's actually happening in states we compete with. I'm determined to get that going here.*

New War Chest In Virginia: In late March, Governor Wilder signed legislation that gives him a "deal-closing fund" of $4.5 million. The governor can commit the money without legislative action, though he is required to consult with the heads of the appropriating committees in each House. The advantage, according to the Governor:

> *During a period of tight budgets and scarce resources, this fund will allow Virginia to provide that extra touch that might do the trick in luring new business and commerce.*

Reviving Smokestack Chasing In Ohio: Shortly after his election, Governor Voinovich established an operations improvement task force headed by a Cleveland banker and backed by half a million dollars in private money and 250+ private sector volunteers. The group concluded the Buckeye State's development agency's mission is "to assist in retaining and expanding business already in Ohio, attracting new business to the state, and promoting Ohio exports." It recommended the agency: (1) concentrate on this goal, (2) eliminate some newer approaches to development like a seed development fund for university research and seven small business innovation research and technical innovation centers, (3) make management improvements including setting clear goals, and (4) if the goals aren't met in several years, "contract out the Business Development Division to a private non-profit organization with a board appointed by the governor."

Smokestack Saving: In an environment of industrial retrenchment, the logic of smokestack chasing dictates trying to save industry already in place so cutbacks in multi-state firms take place somewhere else. In the lag between GM's announcement that it would close several auto plants and the designation of the plants, there was intensive effort by some states and communities to stay off the hit list.

GM contends: "The plant decisions were based on internal factors and the economic realities of the world automotive market. Political considerations were not part of our decision process." This didn't prevent actions such as designation of the "Texas Commitment" to keep a plant open by guaranteeing Texas purchases of alternative fuel vehicles from GM and tax and zoning concessions that were part of the local county and city effort to keep its plant at the expense of one in Michigan.

Many state and local officials as well as business leaders don't like these special deals, but endorse them anyhow. An editorial comment by a leading Texas newspaper (Austin American-Statesman (1/7) indicates the ambivalence:

> *Offering some companies fiscal advantages not available to others is bad public policy.*
>
> *Unfortunately, in the case of General Motors, the state has no choice. Too much is at stake.*

TECHNICAL NOTES

Tough Times, Tough Choices: Two other aspects of tough choices appear in Issue 5: (1) fiscal moderates facing a short-term problem requiring immoderate tax increases or sharp cuts when their solutions, like rainy day funds and improved budget procedures, are long term and (2) uniquely difficult problems in New York because of unusual constraints on raising taxes, borrowing money, and cutting local aid.

Public Opinion. Changes In The Legislatures (Midwestern Office, Council of State Governments, 641 E. Butterfield Road, Lombard, IL 60148) is an easily read combination of statistics and comments by Midwestern legislative leaders about changes in legislative tenure, professionalism, and challenges. The exit poll results appeared in the Washington Post (3/18 and 3/19) as did the poll on middle class tax cuts (3/19). The Illinois Policy Survey results are summarized in Illinois Issues (Feb.). The Montana Poll was reported by the Great Falls Tribune (12/22/91); the Kansas poll, by the Wichita Eagle (1/19).

The health survey for the Advisory Council on Social Security (200 Independence Ave., SW, Washington, DC 20201) is summarized in its final report, Commitment To Change. A good compilation of opinion on national health care issues appears in The American Enterprise (Mar./April). The graphic was developed by **Reports** from a January poll done for the Health Insurance Association of America. The question was: *Let's assume for a minute the government did decide to get involved to try to provide health insurance coverage to the 30 or 40 million people who currently are not covered. To assure that all Americans had health insurance coverage, would you be willing to pay as much as ...?*

Respondents were given a listing of choices (e.g., $200-400). The graphic is based on the assumption that 35 million people would benefit from the plan, that no added money would be used to cover gaps in existing plans, and that coverage extension would cost $2,500 per person. Respondents were presumed to be making statements about willingness to pay that would generalize to about 150 million adults, but not children.

The approval ratings chart was derived from polls reported in The American Enterprise (Jan./Feb., 1992). Because of differences in timing, samples, and question wordings, using the chart to compare governors of different states isn't appropriate. These problems don't affect comparing popularity of governors of one state at different times.

Safety In The Workplace: The study was developed by the National Safe Workplace Institute (122 S. Michigan Ave., Chicago, IL 60603). The review copies used a long title, Basic Information On Workplace Safety & Health In The United States, 1992 Edition, Including A State-By-State Analysis & Profile, which might be improved upon in the final version. The Presidential campaign has stimulated interest in comparisons of Arkansas with other states in many dimensions. Business Week (2/10) uses rankings from several different organizations to conclude that Governor Clinton's "probusiness record as governor runs counter to his rhetoric."

Legal Challenges To State Taxes: For background on taxing mail order sales and state-by-state estimates of revenue potential, see the Advisory Commission on Intergovernmental Relations (Washington, DC 20575) study, State Taxation Of Interstate Mail Order Sales and the Commission's Intergovernmental Perspectives (Winter 1992). A reversal of the "welcome stranger" aspects of Proposition 13 would trigger a wide-ranging reappraisal of California tax policy with options described in the California Assembly Office of Research study, Legal Challenges To Proposition 13.

Corrections, Amplifications: The trouble with computerized "cut and paste" compared with the manual method is that overlooked scraps go to electronic heaven rather than resting on the table as reminders to stick them in someplace. This was the fate of the technical note to the 50-state table on persons without health insurance that appeared on p. 14 of Issue 4. The data came from the Employee Benefits Research Institute (2121 K St. NW, Washington, DC 20037) -- a competent source of information and further referrals on employee benefits as well as the lack of them.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 8

IN THIS ISSUE

Under pressure to do more to encourage development, state officials are looking for improved strategies. But many important decisions are being made deal-by-deal in multi-state competitions. Companies may try to appear more footloose to share concessions made to mobile firms.

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- Selecting Development Strategies p. 3
- Industrial Development Advertising p. 4
- Fighting It Out, Deal-By-Deal p. 6

Assessing how successful state strategies have been isn't easy because so many other factors affect job growth.

- Measuring Success Of Development Efforts p. 10

State officials seek new ways to raise revenue without "raising taxes." Calling a tax increase a spending cut is popular this year.

- Revenue Enhancement p. 12

Child welfare programs are costing more but may be producing less as courts play an increasing role in determining state programs.

- Children As Wards Of The States p. 17

From states that have concluded their legislative sessions comes evidence that legislators found their achievements slight, their working environment unsatisfactory, and their job satisfaction so low that many will opt not to seek reelection. Not just legislators are unhappy with the jobs they are doing. Voters aren't impressed either.

- Legislative Frustration, The Early Returns p. 19
- Public Opinion p. 21

Miscellany covers a setback to controlling corrections costs, preparing for economic recovery, and legislative banks. Technical notes detail many sources, few caveats, one error, and one omission.

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- Technical Notes p. 24

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April 1992 (Second Of Two April Issues)

THE ECONOMIC DEVELOPMENT PRIORITY

Economic development remains a popular theme for state elected officials of all political persuasions. It is the key to solving two persistent major problems -- constituents without jobs and state revenues that don't grow fast enough to cover current spending. Economic problems are constantly put in front of everyone by the media. Debates over economic problems and their solutions are a major part of the Presidential campaign. Development unites welfare recipients blaming problems on lack of economic opportunity, blue-collar workers fearing layoff, and millionaires facing bankruptcy.

The Public Likes Jobs: Polls confirm the widespread concerns. ABC News found a steady increase in Americans describing the state of the nation's economy as "not so good" or "poor." That percentage was 91% in December, up from 53-60% in the late 1980s. A survey late last year shows that nearly 35% of Michigan residents identified jobs as the most important issue. The next highest concern was crime and drugs (just under 20%), followed by education (12%). Topics scoring under 10% (from more important to less) included the state budget, property taxes, assisting people in need, the environment, access to health care, ethics of elected officials, insurance rates, and abortion.

Governors Like Jobs: The state-of-the-state messages illustrate the emphasis. In South Dakota and Wisconsin, where economies are doing well, governors devoted their messages to touting the results and exhorting legislatures to do more and better. In states suffering most, the governors typically bemoaned the situation and presented proposals to make things better. For example, in Maine, Governor McKernan linked the themes of austerity, tax increases, and development. He told legislators:

> *On every vote you cast this session, you must ask yourself two basic questions. First, "Will this help save or create jobs?" And second, "Can we afford it?"*

Legislators Like Jobs: Before the legislative sessions are complete, many new development measures will have been passed. The recent special session in Arkansas may be a sign of the predatory times. Arkansas officials were aware of reports that aerospace firms were dissatisfied with their California location. The response was the Arkansas Aviation and Aerospace Commission with $10 million to seek aerospace-oriented firms. This kind of money won't lure Boeing from Seattle, but could loom large in location decisions of aircraft component suppliers.

Despite a fiscal situation that didn't permit salary and state aid increases large enough to cover inflation, New Mexico legislators passed many new development initiatives this year. They too now have an aerospace supplier program. There is more money for stimulating development across the board and new special incentives for oil production, coal production, and film-making.

SELECTING DEVELOPMENT STRATEGIES

> *If the states are to successfully navigate the turbulent transition from the conventional to the emerging economic paradigm, they will not only need sound economic theory and an effective economic strategy. They will also need* ***institutional change strategy*** *that, more like a compass than a road map, points them in the direction of the emerging paradigm, and moves them forward at a pace and with a surefootedness appropriate to the uncharted territory they are attempting to traverse.*

Developing The Policies: These comments from Scott Fosler (Committee for Economic Development) reflect the common view that states can do a better job of managing development strategies.

This concern is particularly salient in the states that go beyond smokestack chasing and deal-making crafted to suit needs of individual firms with attempts to meld public schools, higher education, manpower training, tax policy, and other policies into a unified state-local strategy. Economic development agencies traditionally aren't given authority to make policy across this broad spectrum. As a result, there is inherent dissatisfaction that states don't have coherent economic development strategies.

Unwilling to turn day-to-day control of such functions as making tax policy and educating youth to development agencies, state officials turn to task forces, blue ribbon commissions, and special reports for advice. As a result, there is a continuing flow of reports on state development strategies. These typically: (1) assess trends and problems in the state's economy, (2) identify industries that offer the greatest potential for development, and (3) consider strategies for enhancing investment and recommend those appearing most promising.

Typical Development Strategies: The vocabulary of the studies is changing over time, though the substance is not. For example, in Arizona's new plan the concept is *strategic planning*, the target industries are *clusters*, and the strategies dealing with infrastructure, worker training, and tax policy are *foundations*. Exogenous employment sources that sell to national and international markets are *high-value industries* with subcontractors in *supply industries*. Endogenous local employers like grocery stores and gas stations are *population-driven* industries.

The recommendations for Arizona closely resemble those of similar reports in other states. They include better education at all levels, a healthy supply of business investment capital, improved quality of life, more infrastructure (including communications), university research and technology transfer, regulatory streamlining, stable and competitive taxes, and tax incentives for business development.

Looking At Failures And Problems: In California, considerable effort is going into attempts to diagnose the sources of the state's economic problems. There have been studies by the legislature (Assembly Office of Research), business associations, a utility, and various academics. The concept is to identify sources of dissatisfaction by firms currently in California, particularly those that have chosen to make their expansion investments in other states.

In less populous Rhode Island, similar introspection is occurring. It is easier because fewer firms and industries are involved. For example, the problems of Electric Boat -- the contractor for the Seawolf submarines that may be cancelled -- are the subject of considerable debate in Congress. Less well known is the competition within the company between its larger facility in Rhode Island and one in South Carolina. The company contends that lower costs in South Carolina make it hard to direct new commercial work to Rhode Island. They cite wage rates, Workers' Compensation costs, and utility charges.

In the mid-1980s Rhode Island produced one of the most comprehensive state economic development plans ever developed, the GREENHOUSE COMPACT. Voters rejected implementation of the $250 million plan.

INDUSTRIAL DEVELOPMENT ADVERTISING

Most states advertise in business publications to publicize their advantages as a place for business to locate. Often there are inserts combining state pitches with those from local utilities, railroads, and local governments -- melded with ads from in-state companies that pay for the magazine space. The pitch made in these advertisements merits occasional review to indicate what state economic development officials see as important. If one state is advertising a public policy considered attractive to business that a second state lacks, it is a good bet that economic development professionals are lobbying for the policy in the second state. This article summarizes recent ads.

Iowa (*The Smart State For Business*) touts high college entrance scores, higher-than-average productivity, and a high graduation rate. Much of its pitch is oriented toward taxes: (1) a "non-unitary" tax that allocates 100% of corporate income on the basis of sales, so there is no Iowa income tax on profits from out-of-state sales, (2) deductibility of federal taxes from corporate income, (3) no sales tax on machinery and equipment, (4) no personal property tax, (5) R&D credits, and (6) "the nation's lowest new employer Unemployment Insurance rate." **Nevada** makes its tax case more simply -- "no corporate income tax, no personal income tax, and the lowest overall tax rates in the nation." It also cites low housing costs, location, transportation, and "the state's pro-business attitude." —

Alabama (*A Perfect Place To Raise A Company*) offers: (1) internationally recognized state universities, (2) computing and creative arts in the schools, (3) over 28,000 miles of glass fiber optic cable communications, (4) free job training, (5) warm climate, (6) "an umbrella of laws -- including one of the strongest tort reform packages in the nation -- to provide a more profitable environment for business and industry," and (7) no property tax on inventories, raw materials, and goods in process. One **Alabama** ad describes the Alabama Resource Center, an aid to site selection including a laser disc system allowing access to a video-disc catalogue of 52,000 Geological Survey maps. **New Jersey** (through a utility company ad) emphasizes its high-tech workforce, location, and transportation and notes its per capita income (#2 of 50 states) and bond rating (AAA).

Georgia, fulfilling a commitment of state leaders to try to encourage development outside the Atlanta area, describes the virtues of other communities and firms already located in them. The **Pennsylvania** advertisement concentrates on location and transportation, but says the state offers "a superior quality of life, a skilled and dedicated work force, and financing programs that reinforce our productive business climate." **Maryland** emphasizes its attitude toward business and state programs like its job training program and venture capital fund. It cites its straight A rankings from the Corporation for Enterprise Development.

Wisconsin uses photos of press reports indicating the state's economy has been thriving in recession. It brags on its business climate ranking, low energy costs, a low cost of living, impressive success rates among business start-ups, and "business taxes that are the fourth lowest in the country." **North Carolina** cites its consistent #1 ranking in gaining new manufacturing facilities. The success is attributed to: (1) a productive well-trained workforce, (2) "right-to-work industrial climate," (3) lowest-in-the-nation construction costs, (4) the transportation system, and (5) "some of the most hospitable communities and diverse recreational opportunities you'll find anywhere."

Arkansas just uses a long endorsement of the state's workers, location, transportation, and business-government relations from the head of Wal-Mart Stores. The decision by a plastics manufacturer to expand in **Missouri** is the basis of the state's pitch for its location, "traditional work ethic," and "pro-business climate." To seal the deal, "Missouri offered site incentives, tax incentives, new infrastructure, and a customized job training program." **South Carolina** advertising is also centered on success in the state by a single firm, Hughes Aircraft in one ad and safe-maker Mosler in another.

Florida calls people "a company's #1 asset in Florida" and promises to show "how better living conditions can improve productivity in the workplace too." **Arizona** focuses on its highly skilled and motivated labor force, a commitment to education, a lower cost of doing business, good location, and "a government that understands and values your business -- and you."

FIGHTING IT OUT, DEAL-BY-DEAL

In theory, most state officials would probably prefer to implement a development strategy reflecting coordinated application of state and local resources, consistent choices of cost-effective incentives, and even-handed treatment of similarly situated firms. In practice, decisions on what incentives to provide under what circumstances are being made case-by-case.

Among other things, this means that state officials are "picking winners," to use a phrase popularized by critics of a national industrial policy. They are deciding among firms making claims that their businesses will prosper and create large numbers of new jobs. They are backing their picks with partly retrievable investments in land, utility connections, and tax abatements. Increasingly, they are backing their picks with cash outlays in the form of risky loans and equity investments that are unlikely to be recaptured if their picks are wrong.

There are three effects of this firm-by-firm, investment-by-investment approach: (1) lots of deals being made, (2) gains to be exploited in some cases, and (3) losses to be taken in others. An unintended consequence is that firms that aren't considering relocation need strategies to try to match two forms of concessions: (1) ones offered by their home state to other firms not their competitors and (2) ones being offered by other states to their footloose competitors.

Legislators Picking Technological Winners -- Utah

Perhaps the best example of technological risk-taking was Utah's decision to support "cold fusion" research at the University of Utah. The concept is to use the principle of the hydrogen bomb to generate electric power. If feasible, such a development could revolutionize energy supply, making the burning of coal and oil for power supply unnecessary. The idea has many skeptics, who view it as the equivalent of the perpetual motion machine. University of Utah scientists gained nationwide headlines in the late 1980s when they announced that their experiments were generating significant amounts of power. Controversy erupted quickly as other scientists said they couldn't replicate the results.

In this obviously risky environment, Utah appropriated $5 million to support the research without any gimmicks -- no backdoor funding, just a normal appropriation. It was fully understood in the legislature as a bet on the technology and its potentially favorable impact on Utah from being the center of development of the power source of the future. A long period of uncertainty followed with episodes like not being able to find the researchers, other researchers not being able to replicate results, and finally a Utah decision last year not to support the research further.

Somewhat ironically, this line of research is being continued (at SRI International in California rather than in Utah) by the Electric Power Research Institute. The Institute gets its money from electric utilities that recover the costs from customers in state-approved electric rates.

Lots Of Deals Being Made

No one can systematically track the concessions being made daily by state and local governments to lure and keep footloose job-generating firms. The offers that aren't accepted remain confidential. Successful offers aren't systematically reported to any central source. Anecdotal evidence suggests that the stakes are large and growing.

The McDonnell Douglas plan for a new aircraft manufacturing plant may never materialize, but it won't fail for lack of state and local interest. Alabama, Arizona, Illinois, Louisiana, Missouri, Oklahoma, Texas, and Utah are all in the running. Significantly, California, where the company now has production facilities, is not. The bids are said to offer several hundred million dollars in concessions and direct aid each, implying costs-per-job in the $30,000 to $50,000 range. This can be divided by two if each job associated directly with the plant has a multiplier providing one additional local job.

Because of a depressed commercial real estate market, companies with the capacity to move office work from one state to another have massive leverage. One of the most striking recent deals concerns the new glass tower on Times Square in New York. The mortgages on the new unoccupied building, presumably less than its total cost, total $250 million. It is being sold to Bertelsmann A. G. (RCA Records, Bantam Doubleday Dell publishing, and more) for $119 million. The former equity owners lose their investment while mortgage holders take a massive bath. New York City kicks in a package valued at $11 million by exemptions from sales taxes and capping the increases in real estate taxes associated with property improvements.

If one believes reports that the company was considering the move of 500 employees to Chicago and/or Indianapolis, a move to be precluded by a contract with the city, the city's investment is $22,000 a job. The New York Times (3/4) reported that the size of the city's offer surprised real estate experts as the jobs belonged "to a company that was not threatening to leave New York."

Not just money is involved. Press reports indicate that Utah legislators have redrawn Congressional district boundaries to ensure that a particular representative who often clashed with McDonnell Douglas wouldn't be representing the territory where its plant might be located. Concern with development motivated New York to loosen state restrictions on credit card terms and interest charges.

Development considerations are constantly pitted against environmental protection regulation. There have been major issues recently in the Carolinas, Maine, Texas, Virginia, and other states. Development concerns have been used to argue for both loser regulation of banks (so outside banks will come in) and tighter regulation (so outside banks won't swallow local ones). Some states have changed their laws on corporate governance (e.g., powers of shareholders in conflicts with management) as economic development measures.

Exploiting Gains

There are few recent success stories from state development efforts. One is United Airlines' decision to locate a maintenance base, with as many as 6,000 jobs, in Indiana. The governor estimates that the facility will generate $500 million in new tax revenues over and above the $172 million the state is providing as incentives. He recently announced education investments to train Hoosiers for the new jobs. The graduation rate of certified aviation mechanics will be stepped up to 425 a year from about 185 currently. Purdue University will begin to offer degrees in aviation administration.

Taking Losses

State and local governments can easily be left holding the bag from industrial development investments. In some cases, as in venture capital funds and speculative development of industrial parks, the state's potential losses are known at the outset.

In "bird in the hand" industrial development financing, the investment appears less speculative because it is tied to specific decisions by a firm to make investments of its own. But when a firm is willing to write off its own investments, it is also writing off the state and local investment.

One old example was the pioneering action by Pennsylvania to draw a Volkswagen plant. The plant was closed long before the useful life used in justifying the state's investment. Similar situations are arising with considerable frequency as recession stimulates companies to prune older production facilities and competition washes out new firms backed by state venture capital.

With stakes in the financial viability of firms that owe state agencies money as well as employ state residents, **state officials are increasingly confronted with decisions about whether to put additional money into troubled firms.** The fear is throwing good money after bad. The hope is that more capital will enable fundamentally sound firms facing temporary adversity to survive.

Two years ago, Colt's Manufacturing Company, maker of the famous Colt 45 pistol, was in danger of failing. The bailout was to buy the company from its parent, with Connecticut pension funds putting up $25 million and taking a 47% ownership share. In March, the company filed for Chapter 11 bankruptcy. Its petition indicated it had a negative net worth of $9 million. This would mean if the company were liquidated, stockholders, including Connecticut, would receive nothing. The governor announced that the state will guarantee $2 million in loans as part of the effort to keep the company operating.

Looking At Firms That Won't Move

The impact of stiff industrial development competition is not captured by examining concessions now being made for identifiable plant location decisions. **Firms with no immediate location decisions to make are using the possibility of locating elsewhere as leverage over state and local policy.**

Boeing is a good example. Boeing competes with McDonnell Douglas and Airbus Industries, a government-subsidized European firm. Boeing is locked into the State of Washington for current production and for the new 777 jetliner. Sometime, probably in the next century, there will be a new plane, perhaps a 600-800 seat one that would justify building a new production facility. Until then, Boeing is considered immobile, though it can vary where components are produced among its Alabama, Kansas, and Washington facilities and subcontractors elsewhere.

Not to be taken for granted, Boeing's chairman addressed the company's concerns about high costs of doing business in Washington in a Chamber of Commerce speech in December. He told his Seattle audience that company studies indicated that expansion in Wichita or Huntsville would be 30-40% cheaper. He concluded that Boeing wasn't considering relocation, "But the necessity to stay competitive in the world market demands that we consider these costs as a significant factor in our plans to accommodate additional growth." In a comment quickly noticed in Seattle, the company's local plant manager told the Wichita city council that Wichita was a "frontrunner" to get the assembly plant for the next generation of jetliners.

State interest in the problems of firms already located in their state isn't just a matter of responding to the large and sophisticated staffs like those Boeing can devote to pubic policies of the State of Washington and its local governments. For example, a part of the Rhode Island economic equation is the jewelry industry, a cornerstone of the state's manufacturing base. This highly fragmented industry is in serious trouble. It doesn't need threats of moving. Many of the small firms that dominate the industry can't credibly make them. The problem is they may close Rhode Island plants because they lose out to competitors elsewhere, not that they will move.

This situation, and similar ones in other states, argue against tilting state policies to improve the competitiveness of one major employer like Electric Boat's Quonset Point shipbuilding facility. Rhode Island could systematically reduce Electric Boat costs by shifts in how it allocates utility costs among customer classes, its experience rating and payroll base in Unemployment Compensation, and its insurance plan features for Workers' Compensation. But shifts from the high visibility submarine maker to the low visibility jewelry companies and their counterparts in other industries might be counterproductive.

MEASURING SUCCESS OF DEVELOPMENT EFFORTS

Enthusiasts for state development programs and incentives often have success stories to tell, but it is hard to assess the extent to which the success was caused by the state activity. In some areas, like export promotion, it is plausible that state efforts in the aggregate lead to better national performance. In other areas, such as attracting investments in warehouse facilities and food processing, it is clear that the jobs would exist somewhere in the U.S., making development a zero-sum game.

Merely because the game is zero-sum doesn't mean it shouldn't be played, so legislators can appropriate development funds with the same gusto they bring to such zero-sum games as determining who gets the best general admission seats or which states have the best athletic teams or physicists. But if those spending state money for development defend their work based on beating competitors, legislators will ask for the equivalent of sports standings -- data on how well they are doing relative to the competition.

The information available on how states are doing isn't helpful in showing how state development policies are doing. Those development efforts are only a part of the total aspect states present to business, including labor law, tax policy and more. And these are only a part of the total state environment which includes uncontrollable factors like climate, location, and raw materials. And these are only a part of the jobs picture which is heavily influenced by changes in technology and consumer preferences, international competition and U.S. trade policy, and more.

Considerable effort goes into academic studies to assess the impact of state development efforts. Two recent ones illustrate the problems in using the results as a guide for state strategies.

A statistical assessment finds that larger state export promotion budgets are associated with smaller total exports. Other things being equal, more staff seems to be better than less. But how many overseas offices are maintained doesn't make any difference. A recent assessment of the correlation between public infrastructure investments and the growth of manufacturing productivity suggests the "link is weak." Other studies have produced the opposite result.

Reading the academic studies isn't for everyone. Readers need to know that a *dummy variable* isn't an ill-informed legislator vacillating on how to vote. To assess the export study, readers should have an opinion on whether, when faced with heteroskedasticity and auto-correlation, they should abandon OLS and turn to LSDV or GLSE. {If you thought that sentence was about what drug to take after dealing with sex deviation situations, you may want to consider whether university research on public policy is doing anything for people making state policy decisions. -Ed.}

Job Growth And Decline

The numbers of new jobs that state officials announce as associated with new corporate plants and expansions have two massive problems: (1) many of the announced jobs never materialize and (2) the numbers don't reflect jobs lost by plant closings and contractions.

In broad overview, the critical numbers are the changes in total employment in each state (see Issue 6). However, they can be highly misleading because they reflect booms in construction and real estate that may not be sustainable. They also include jobs in service industries, retailing, and state and local government that cannot be sustained without a strong economic base. That base comes from what economists call *exogenous* economic activity, business created when in-state firms sell to national and international markets rather than when residents sell to each other.

New plant announcements, broadly defined to include transportation and distribution facilities as well as manufacturing plants, provide one indicator. There were 3,084 such facilities announced in the U.S. in 1991. Six states dominated -- Florida with 281, North Carolina with 276, Texas with 261, California with 191, Alabama with 156, and Kentucky with 152 -- together accounting for 42% of the national total. The winners list changes considerably when the number of new facilities is related to state population as is done on the table.

New Corporate Facilities And Expansions Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Mississippi	49.0	18	Missouri	14.5	34	Idaho	6.7
2	North Carolina	41.0	19	South Dakota	14.2	35	California	6.3
3	Kentucky	40.9	20	North Dakota	12.6	36	New Jersey	5.8
4	Alabama	38.2	21	Kansas	12.4	37	Maryland	4.9
5	South Carolina	26.4	22	Alaska	12.3	38	Illinois	4.9
6	Oklahoma	25.8		**United States**	**12.2**	39	Michigan	4.9
7	Indiana	22.5	23	Utah	11.3	40	Minnesota	4.5
8	Florida	21.2	24	Louisiana	10.3	41	Rhode Island	4.0
9	Nevada	20.2	25	Delaware	10.3	42	New York	3.5
10	West Virginia	20.0	26	Ohio	9.6	43	New Hampshire	2.7
11	Arkansas	19.8	27	Washington	9.6	44	Pennsylvania	2.5
12	Iowa	18.2	28	Arizona	9.1	45	Massachusetts	2.5
13	Georgia	18.0	29	Wyoming	8.7	46	New Mexico	1.9
14	Virginia	17.0	30	Oregon	8.2	47	Vermont	1.8
15	Tennessee	16.8	31	Colorado	8.0	48	Connecticut	1.2
16	Wisconsin	15.1	32	Hawaii	7.9	49	Maine	0
17	Texas	15.0	33	Nebraska	7.5	49	Montana	0

Southeastern states clearly dominate the list. They hold the top five positions, all of which are more than twice the national rate. Traditional industrial states of the Northeast and Midwest and California are all below the national average. Small states generally do badly, even when the comparison is made on a per capita basis. Seven of the ten least populous states are below the national average while the other three, the Dakotas and Alaska, are barely above it. Looking at a broader time horizon, announcements in the past three years rather than the past year, doesn't change the pattern of Southeastern dominance. The exception is Nebraska which is #2 on a three-year basis. The other states in the three-year top five are Alabama (#1), Mississippi (#3), North Carolina (#4), and Arkansas (#5).

All states are losers in drawing investments in giant plants. Only one of the ten most costly facilities -- all representing an investment of at least $1 billion -- is going to the United States. It is the United Airlines maintenance facility slated for the Indianapolis area. The five largest, all over $1.5 billion, are a Ford/Volkswagen plant in Portugal, a steel mill in Malaysia, and giant petrochemical plants in Taiwan, China, and South Korea.

REVENUE ENHANCEMENT

With state officials desperate to find election-year ways to avoid raising taxes without cutting spending, there is considerable pressure to use easy solutions. Examples are: (1) reducing retirement contributions by assuming greater return on investments or changing actuarial methods, (2) delaying spending into the next fiscal year, (3) selling and leasing back assets, (4) borrowing short term, and (5) shifting spending from the general fund to other funds, particularly to bond funds. Much of this inventory of ideas for apparently painless lowering of spending has now been used.

Because these ideas provide one-time financing for ongoing spending, like school aid and employee pay, they are inherently addictive. Each use requires subsequent use of equal or larger quantities. The alternative is painful withdrawal. Sophisticated players in fiscal politics recognize this and know that withdrawal will cause an unpredictable mix of higher taxes and cuts in major spending flows, such as education. As a result, taxpayer groups, business leaders, and education interests all become increasingly nervous over reliance on easy, but one-time, fiscal fixes. Bond ratings, which have been declining, and warnings from rating agencies, which have been increasing, provide barometers of concerns.

So the search for painless budget solutions focuses more and more on raising multi-year revenue flows. Most mechanisms are well-known, but there are new twists.

A Tax By Any Other Name

Phrases to describe raising taxes without saying so don't stay current long because they quickly become objects of derision. This is becoming the fate of *revenue enhancement*. One device in use this year defines sales and personal income taxes as *general taxes* or *broad-based taxes*. Increases not affecting them are implicitly treated as more acceptable because they don't involve increasing general or broad-based taxes.

"Not a tax, but a *contribution*" was what Governor Wilder called the health provider gross receipts levy he unsuccessfully urged this year. Governor Thompson, who appeared with him on CNBC-FNN (3/18), accepted this phrasing as they attributed problems in Virginia and Wisconsin Medicaid budgets to federal decisions, particularly mandates. The use of *contribution* for provider taxes is natural for governors seeking to replace provider donation programs (soon to be unacceptable under new federal rules) with provider taxes. However, it hasn't been persuasive with the many people not familiar with the history of Medicaid financing. A mandatory levy on gross receipts that is characterized by opponents as a "sick tax" just doesn't sound like a donation.

Revenue enhancement is rapidly being replaced by *loophole closing* as a way to describe tax increases. This usage is common to characterize broadening of the sales tax base. In appears in connection with other proposals based on the concept that a particular group isn't paying a fair share, such as very high income taxpayers who pay the same top bracket income tax rate as middle income taxpayers.

Fee Increases

> *It's a fee increase and it's a revenue enhancement process, so you might as well call it a tax increase.*

Comments like this are common in states where governors are seeking to maintain a posture of not increasing taxes while simultaneously enhancing revenue collections. The quote is from the speaker of Michigan's House during extensive March debate on fee bills that are part of the mechanisms to balance the FY 1992 budget. The legislation will raise $0.4 million annually through food service license fees, such as doubling to $2 the fee for vending machines.

Florida has been particularly active in the use of new fee concepts. It pioneered in the use of impact fees of several hundred dollars for registering vehicles that don't replace ones previously registered in the state. Georgia copied this device this year. Florida's one cent fee on bottles and cans is scheduled to go into effect in October. A recent calculation by Dade County contractors concludes fees per square foot of warehouse construction have gone from nine cents in 1988 to $1.35 this year.

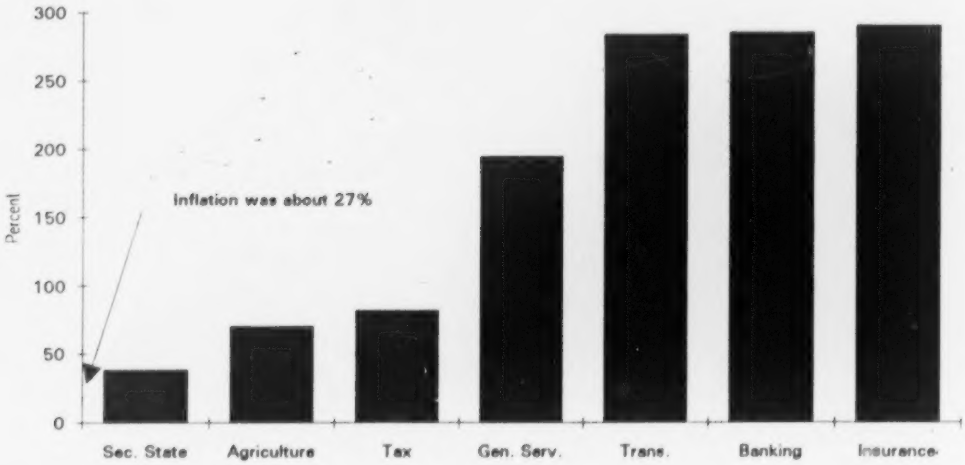
New ideas continue to emerge. Maine's legislature considered a $2 fee on cats to finance animal welfare programs, but backed off quickly after public protests. Some New Hampshire communities are assessing drunk drivers for the costs of their arrest and prosecution. California's supreme court recently decided that school districts can charge parents for bussing children to school. A proposal in the Pennsylvania legislature would assess marchers and demonstrators for the costs of police protection, including that necessitated by any counter-demonstrations.

The private sector has been quick to use automatic billing through phone numbers as a way to sell services. The 900 concept has spread beyond Dial-A-Porn to ways to get sports news and weather from your local newspaper and financial information from the Wall Street Journal. In a question and answer period following a speech by **Reports** editor Hal Hovey to a business group, this exchange occurred:

> ***Question***: Recently our state has begun to use 900 numbers for providing information held by the state such as registration status of corporations. Is this common? Is it a trend?
>
> ***Answer***: I am not aware of this as a trend, but it could be happening. I can see why the concept might be attractive to some state officials. So I'll mention it in **State Policy Reports**, which may make it a trend.

The chart shows trends in fees charged businesses by New York State agencies.

Percent Increase In Business Permit Fees
New York State, FY 1985 To FY 1991



The smallest increase of 38% was well above overall consumer price increases of 27%. The worst news came from increases too large to show -- 1,241% in Labor Department fees and a 2,161% increase in environmental permit fees.

Professional License Charges

Taxing professional services is an important issue, but a sales tax on the service may not be the vehicle. **There is increasing interest in taxing licensed professionals by a direct tax on them associated with holding a license.** The traditional license fee is set at a level consistent with the state's cost of maintaining the paperwork of the licensing process, paying licensing boards and their staffs, and conducting disciplinary proceedings. In some states, there are additional levies associated with covering losses associated with misconduct in the profession (e.g., lawyers and real estate brokers who abscond with client funds) and/or with extension of that profession's services to those unable to pay (e.g., indigent criminal defense).

There is no limit when going beyond these charges to much higher ones based on registration. Many states tax trucking this way. A substantial portion of truckers' highway user charges comes from vehicle registration -- technically permission to drive on highways parallel in concept to permission to practice law or accounting.

New Jersey opened this door wide with its 1990 auto insurance reforms. To reduce costs that consumers would otherwise see in auto insurance premiums, the state levied additional fees in the hundreds of dollars on some of its licensed professionals, such as health care providers.

The topic is currently a hot one in the District of Columbia. The mayor proposed that professional license fees be based on gross receipts. Fearing that the levies might drive professionals to nearby suburbs and contravene federal law prohibiting the District from taxing commuters, the city council rejected the idea. But it followed the basic concept by increasing the standard professional license fee from $100 a year to $250 a year and increasing the personal property tax on furniture and equipment -- which in the District is primarily a tax on office equipment.

The tax plan recently passed by the Maryland Senate broadened the sales tax to include many consumer services as well as goods (e.g. to snack foods and newspapers) now exempt. It didn't apply the tax to professional services, but did increase the licensing fee for lawyers to $125 a year. This fee didn't survive in Maryland's final bill, but a $200 annual privilege tax is part of legislation recently approved in Tennessee. From A to V, it reaches state licensed professionals: accountants, agents, architects, attorneys, audiologists, brokers, broker dealers, chiropractors, dentists, engineers, investment advisors, landscape architects, lobbyists, optometrists, osteopaths, pharmacists, physicians, podiatrists, psychologists, speech pathologists, and veterinarians.

Packaging Revenue Increases As Spending Cuts

The ultimate in satisfying both those who want to spend more and those who want to cut taxes is to portray tax and fee increases as spending cuts. Describe a tax increase as a spending reduction? This isn't as crazy as it sounds.

Fee increases are already presented as spending reductions in some states and in the federal budget. The result occurs automatically if fee revenue is included as an offsetting receipt within an agency's budget totals. The higher the fee, the higher the offsetting receipt, which appears in budgets as a ***negative expenditure***. These negative expenditures offset positive ones in the net spending totals presented in budgets.

A similar offset occurs in particular funds, like state general funds, if an earmarked tax, like the gasoline tax for highways, is increased and the revenues are used for spending that would otherwise be covered by the general fund. This is not of merely academic interest. A substantial portion of the $1.1 billion *cut* in Medicaid and welfare spending in the newly enacted New York budget comes from *an increase* in revenues from health care provider taxes.

These kinds of shifts have become widespread. They will cause major differences between state spending increases as reported to the press locally and in national surveys by organizations of state officials and the spending increases that will ultimately be reported by the Census Bureau. In simple terms, state spending on an apples-to-apples basis is growing much faster than is currently being reported.

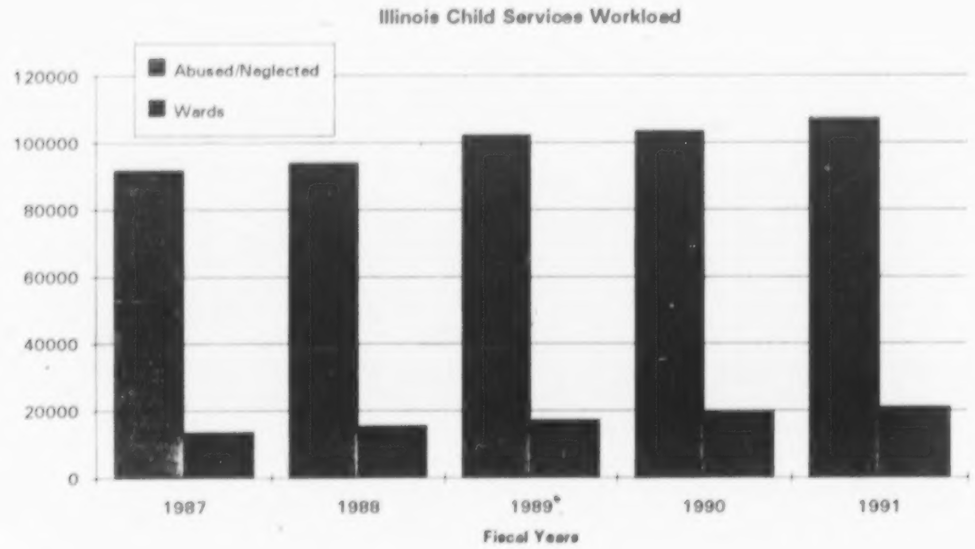
Spending Cuts By Shifts To The Private Sector

There has always been substitution of private effort for cutbacks in public spending, but the movement is voluntary. Expenditures on private security services, private campgrounds, and private schools are to some unknown extent larger than they would be if governments spent more on police, parks, and schools. A more obvious shift is to discontinue a government activity but require essentially the same or more activity from the private sector. This reduces the government spending for the activity while ensuring that it is carried out to standards set by government.

New Hampshire's handling of the weights and measures function shows how the shift works. Like other states, New Hampshire protects consumers from vendor cheating by periodically checking devices used to measure goods sold by quantity, such as supermarket scales and gas pumps. The old practice was for state inspectors to perform this function. The new practice is to require merchants to purchase private inspections and send proofs of the results to the state, along with fees for state employees to monitor the reports.

CHILDREN AS WARDS OF THE STATES

Child welfare issues are a major topic in many legislatures this year. The underlying problem is easily understood, but not easily resolved. One of the results is a rapidly growing workload for state agencies dealing with children. The graph shows the growth in the number of children reported as abused or neglected in Illinois and a continuing increase in children in "substitute care." That category includes children placed by the state in homes of relatives, foster care homes, group homes, and institutions.



Growing public concern over child abuse and an apparent increase in the number of young children of drug-abusing mothers has increased the number of children for whom state intervention may be appropriate. **States are subject to criticism no matter how aggressively or passively they approach these situations.**

An increasing number of natural parents are making widely publicized complaints that the states are unnaturally intervening in the family, inappropriately taking children from their parents, and creating an environment destructive of normal family life. Conversely, there are many well-publicized examples of child abuse and even death stemming from situations in which states didn't act quickly enough to take children away from their parents. Criticized for acting both too quickly and too slowly to take children from natural parents, child welfare agencies tend to leave the children in an in-between status.

One result has been to increase the number of children that have ties to *both* state governments and natural parents. The children may be in temporary custody of welfare agencies, in special homes, or temporary foster care. Or, they may be in the custody of the parent(s) with state involvement such as counseling and monitoring for detection of abuse or other problems. With attempts to restore the normal home setting underway and the natural parents' right to custody not extinguished by legal action, the children can't be placed permanently.

In Massachusetts, for example, there are about 3,500 children at any one time that arguably are candidates for adoption, of which less than a third can actually be adopted. According to a recent internal report on these waiting children, the cost is nearly $40 million a year. California has over 80,000 children in foster care, up from 28,000 in 1982.

The problem doesn't admit to easy solutions, but does tend to spawn studies. In Massachusetts, a study on foster care reported recommendations in 1988 and there have been several legislative reports on the child protection system. Governor Weld has indicated he intends to appoint a study group on these issues.

Child-welfare systems are under attack in the courts in many states. Ten to fifteen states are under some form of court order dealing with the handling of foster children. Arkansas officials decided to switch rather than fight. The major topic in the recently completed special legislative session was implementation of a proposed settlement to a class-action lawsuit. The legislature accepted it with little dissent and an appropriation of $15 million. Illinois settled last year. One result is a 21% increase in the FY 1992 budget for its Department of Children and Family Services.

In Florida, settlement is tied to broader fiscal issues. From a base of $28 million, the governor wants to add $17 million to the FY 1993 budget for emotionally disturbed children in state care -- about 10,000 of them. But this is just one aspect among many that constitute the $1.3 billion in new taxes he is seeking from a reluctant legislature. He recently took the unusual step of making a personal appearance in a federal courtroom, where he successfully sought an agreement that suspends the pending litigation while he works on the legislature to provide additional money.

A late March divided opinion of the U.S. Supreme Court (Suter v. Artist M.) will probably further muddy the legal waters. The decision itself was good news for states. The Court held that individual plaintiffs didn't acquire standing to sue states on foster care issues because of the wording of the federal Adoption Assistance and Child Welfare Act of 1980. Parallel language in the federal Medicaid statute and certain dicta suggested that states may now be in a stronger position to resist litigation by hospitals and nursing homes over reimbursement rates. But many child welfare suits depend upon other state and federal statutes and constitutions, so some observers predicted more, rather than less, litigation in the child welfare field will result from the Suter decision.

LEGISLATIVE FRUSTRATION, THE EARLY RETURNS

> *This has not been a truly significant session. There's been no legislation to turn the hard economic times around, or eradicate educational disparities, or address critical needs or transportation, and it was within our power to do all of that.*

Negative reviews, like this one from Virginia's House Majority Leader, are pouring in as legislative sessions end. Legislative leaders and backbenchers alike report that the sessions are setting records for member dissatisfaction with their accomplishments, their workload and procedures, and the lack of appreciation for their work by constituents.

Virginia (see box) shows the sources of frustration. The test is not whether legislators did "the right thing," but how they felt doing it. Another test is whether what they achieved is a good-enough explanation to a spouse or 10-year-old for long hours away. For citizen-legislators, another test is whether the rewards justified the time off the job.

If It Feels Good, Do It -- Fiscal Outcomes In Virginia

A decision not to raise taxes guaranteed a tight fiscal situation which precluded major initiatives, disappointing those who hoped to make their mark with new programs and better funding for current ones. Strong interest in school finance equalization was converted into a compromise that splits minor new money between poor rural districts and rich Northern Virginia districts to avoid cuts from equalization criteria. Without new money, legislators avoided new education quality measures. In higher education, debate was over whether to scale back past initiatives, like the Center for Innovative Technology, not new initiatives.

Health care initiatives were constrained by the fiscal situation and the need to replace current Medicaid bootstrap financing. The provider tax proposed by the governor was dubbed a "sick tax" by the hospital administrators who opposed it enough to scare off tax-shy legislators. Covering health initiatives by increasing the lowest cigarette tax in the nation drew opposition from tobacco growers and manufacturers. The compromise avoided a state increase but allows Northern Virginia counties to raise cigarette taxes if their voters approve.

Scheduled tax relief for the poor by a sales tax exemption for nonprescription drugs was sacrificed to fiscal necessity. Instead, legislators adopted a tax increase that won't draw much attention, adding sales tax to the prices charged in state-owned liquor stores. A transportation plan with accompanying gas tax increase, which the legislature has authority to enact, became a bond issue, permitting voters to approve the plan and a small gas tax increase in November. The governor vetoed the tax portion and part of the spending because the "mere presence" of a tax increase on the ballot would jeopardize three other bond issues in the same election.

Legislators who judged their performance by downsizing government or reducing spending didn't get much satisfaction out of the session either. There were no dramatic program cuts, instances of privatization, or reorganization of state functions. Much policymaking consisted of finding new ways to finance current activities, not finding less to finance. Examples: reducing retirement contributions without reducing benefits, financing universities with more tuition and less state aid, and financing construction with bond issues rather than general revenue.

One knowledgeable observer, surveying the national pattern of frustration and job dissatisfaction, points out that people run for the legislature because they want to do something. Being cast in the role of nay-sayer isn't comfortable for Democrats or Republicans. Friends from churches, clubs, and neighbors are asking more "Why did you ...?" and saying less, "I think its great that you ..." Less senior legislators, always disappointed to learn that not all legislators have equal power, have their own frustrations. One in Maine has joined the new *mushroom caucus*. According to the Boston Globe (4/5):

> *Freshman Rep. Donald H. Gean did not define just what the mushroom caucus is, but he didn't have to. Disgruntled rank-and-file lawmakers who feel left out of the process often refer to themselves as mushrooms that are kept in the dark and fed what might politely be called horse manure.*

Record numbers of Members of Congress aren't seeking reelection. Some have issued statements expressing frustration with Congress as an institution. Some have special reasons for leaving -- the House bank scandal and a final chance to convert campaign war chests to personal wealth. They share other reasons with legislators: (1) stiff opposition in reapportioned districts, (2) anti-incumbent sentiment, and (3) dissatisfaction with their work, pay, and working conditions. Counts of retiring state legislators aren't yet available, but anecdotal evidence suggests they may also experience unusual turnover. For example, a third of Georgia legislators won't be back, not counting ones who will lose reelection bids.

Wyoming Speaker "Rory" Cross will be one of the legislators not returning by choice. He called this year's session the most contentious in his 18 years of service. No novice at contentiousness, Cross gained local fame last year by describing a tussle with local police (resulting in a misdemeanor guilty plea) as "discussions about law enforcement in Wyoming." The Senate President, with 20 years of service, is also leaving.

If It Feels Good, Do It -- Fiscal Outcomes In Maine

In Maine, where the fiscal situation is even tighter than in Virginia despite large tax increases last year, there were even more reasons for frustration. Several years ago, Republicans and Democrats both achieved parts of their property tax relief agendas with a hybrid plan. Legislators have been backing out of the plan ever since, while making decisions on school and other local aid which greatly increase pressure for local property tax increases. Another major legislative achievement was a universal health plan which has now been whittled down to a paper tiger.

Even frustration-relieving screaming was off limits for Maine legislators this year. Majority Democrats concluded that last year's shouting matches with Republican legislators and a Republican governor, a delayed budget, and stalemate on Workers' Compensation after long acrimonious debate were giving legislators a bad name and possible trouble in the fall elections. So they imposed a gag order on themselves, in the process greatly inhibiting partisan criticisms from Republicans. Workers' Compensation reform, still unresolved, goes to a Blue Ribbon Committee, state reorganization issues remain for consideration next year, and legislators have quietly left Augusta.

PUBLIC OPINION

Governor Wilson is seeking to put an initiative on the November California ballot that combines welfare reform with procedures designed to ensure that the state budget is adopted by the June 15 deadline. Recent California Poll results suggest considerable support for cutting salaries as discipline for budget timing, but reluctance to trust the governor to set the budget unilaterally. The welfare reform comments get a mixed review.

California Voter Opinions On Budget And Welfare Reform

Policy	Favor	Oppose	No Opinion
If the budget is not passed by June 15 each year, should the governor and state legislators forfeit their salaries and per diem payments until the state budget is passed?	83%	13%	4%
Should the governor be permitted to declare a fiscal emergency if the legislature does not pass a state budget by July 1?	30	66	4
Reducing welfare payment to low income families with dependent children from an average of $663 per month to $597 per month for a family of three.	34	61	5
Reducing welfare payments to low income families with dependent children after they have been on the program for six months to an average of $507 per month.	40	53	7
Increase welfare payments by $50 a month to teenage mothers who stay in school to complete their high school education and cut payments $50 a month if they stop attending school regularly.	87	10	3
When low income families with dependent children move to California from another state, limit their monthly welfare payments in the first year to an amount no higher than what was being paid by the state which they left.	76	20	4
Do not increase the amount of welfare payments to low income families when they have additional children.	58	37	5

Another question was: "If Gov. Wilson and the legislature are at odds as to how to reduce the budget deficit, and you didn't know anything about the specifics of the matter, whose position would you be more inclined to support?" The legislature won this trust contest by 54% to 32% (rest undecided) in the January 1992 poll, up from its 47-38 margin when the same question was asked a year earlier.

Voters think their legislature is doing better than the Congress, but don't think much of either. The ratings increase when the responses are confined to those who say they know who their own representative is. That knowledge is claimed by 35% of Californians for their Member of Congress, 28% for State Senators, and 21% for Assembly Members.

Californians View Their Legislators: Job Performance Ratings, Early 1992

Legislator	Excellent/ Good	Fair	Poor/ Very Poor	No Opinion
All Responders				
Member Of Congress	13%	38%	48%	1%
State Legislator	18%	44%	35%	3%
Responders Knowing Representative				
Member Of Congress	46%	31%	23%	--
State Senator	43%	36%	14%	7%
Assembly Member	52%	29%	14%	5%

Voters said they would be more inclined to vote for challengers (40%) than incumbents (33%) for legislative office if they knew nothing else about the candidates. When they were asked whether they would be inclined to elect the incumbent or a challenger in their own districts, however, they preferred their Congressional incumbent 41-29% and their State Senate incumbent 42-27%.

Voters find the level of taxes too high in relation to the services they get. In a December poll in Maryland, 63% of voters agreed with the statement, "In general, the value of the services I receive from government is less than the taxes I pay." A third disagreed (rest undecided). Only 38% agreed with the version of the question that specifically covered state government: "All things considered, state taxes are really not too high considering the services the government provides." Fifty-seven percent disagreed.

MISCELLANY

Controlling Corrections Costs, Another Setback

Many attempts to control corrections costs and comply with court orders on overcrowding depend upon actions that let prisoners out earlier than their sentences specify -- good time, early release, work release, furloughs, and other plans. The risk is that some prisoners will commit new crimes while in these release programs, as some inevitably will. When this happens, state officials, remembering the Willie Horton ads about the Massachusetts release program featured in the 1988 Presidential campaign, often curtail their programs. The latest example is Arkansas. No murder -- just hijacking a small plane, stopping for a robbery, stopping again to refuel, and then disappearing. Governor Clinton has ordered a temporary halt to the furlough program. There are comparable examples in other states.

Economic Recovery Planning

It's time for those interested in state policies to start talking about their strategies for the time when state coffers are flush with revenues from the unexpected strength of the coming economic recovery. Is this bad advice? Probably not. Is it untimely advice? It may be.

Reports shares with organizations of state officials like NCSL and NASBO a perfect track record of warning of the recession before its onset and predicting accurately the consequences for state taxes and spending. But we didn't try to predict the timing. This prevented error, but also meant the warnings substantially predated the onset of recession. The same situation now obtains for recovery.

Economic history suggests there will be a recovery, with higher-than-normal growth for a time. The history of economic forecasting suggests that forecasters will miss the upturn, just as they missed the downturn, and that they will underestimate the strength of the recovery. Given this background and the long leadtimes associated with proposals using state resources, savvy players are probably dusting off old ones and thinking of new ones. Examples: tax cuts, a new round of school equalization proposals, higher education quality programs, new attempts to get welfare recipients jobs, and new ways to deal with health care for the poor.

Legislative Banks

The U.S. House of Representatives bank affair raises the question of whether similar state practices exist. **Reports**' educated guess would have been that there are no comparable banks run by or for legislatures. However, Massachusetts may have been an exception. In a back-page story, the Boston Globe (4/1) describes what it considers to be a parallel case. The bank was recently closed. The state treasurer says its records can't be found.

In the early days, state treasurers were custodians of cash and securities. This is why many state capitol buildings have vaults. States didn't issue checks (instructions to a bank). Instead, they issued, and some still issue, warrants (promises that the issuer will make payment on presentation). Banks honored these, though not required to do so. To provide a facility for the redeeming of warrants, state treasurers had cashiers. The cashier function may still be maintained in some state capitols and can be seen in the architecture of some of them, as well as in the U.S. Treasury building. Some of these might have evolved into banking function beyond honoring state paychecks with cash.

In many organizations, there are employee credit unions subject to regulation by state and federal governments. Like private employers, states may provide office space for these organizations but without direct financial involvement.

TECHNICAL NOTES

Economic Development: The Michigan survey by Public Sector Consultants, Inc. (300 S. Washington Sq., Lansing, MI) appears in its Public Opinion Monitor (Dec. 1991). Other polls came from The American Enterprise (Jan./Feb.). Fosler's quotation is from "State Economic Policy," Economic Development Quarterly (Feb. 1992). The Arizona report, Arizona's Economy Is Everyone's Business, was a supplement in the Arizona Republic (3/15).

Iowa's ad appeared in Business Week (3/23). The others are from Site Selection And Industrial Development (Dec. 1991 and Feb. 1992). The academic studies are Charles Hulten and Robert Schwab, "Public Capital Formation ...," National Tax Journal (Dec. 1991) and Richard Cupitt and Margaret Reid, "State Government International Business Promotion ...," State And Local Government Review (Fall 1991). The new plant announcements are tracked by Conway Data, Inc. (40 Technology Park, Norcross, GA 30092) and printed in its publication Site Selection And Industrial Development (Feb.).

Revenue Enhancement: The chart on fees was derived from The Fees That Ate New York: How Hidden Taxes Are Hurting Our Economy. This 51-page study was issued in January by The Public Policy Institute, an affiliate of the Business Council of New York (152 Washington Ave., Albany, NY 12210).

Revenues from other funds can buoy a state's cash position if unspent. This has happened in Massachusetts and the federal government with revenue from gas taxes. The next step in calling tax increases spending cuts could come from revival of *tax expenditures*. The concept is that putting subsidies in the tax code as credits and deductions has the same impact as paying out equivalent amounts. So is cutting tax expenditures (thereby raising taxes) equivalent to cutting spending? Hints of this approach are appearing in California.

Public Opinion: The California Poll results appeared in the Sacramento Bee (February 4, 7, and 14). The Maryland results were reported in The American Enterprise (March/April 1992). For simplicity in presentation of evaluations of incumbents, the values shown are midpoints of ranges. For more polling results, see Issue 7.

Watch Out For Recovery, For a historical review of recessions and the ensuing recovery, see an article by Stephen McNees in New England Economic Review (Federal Reserve Bank of Boston, Jan./Feb.) plus the extensive citations in that article.

Errors And Omissions: Issue 7 suggested that this year Florida Governor Chiles (D) might parallel Connecticut Governor Weicker (I) last year by vetoing budgets until getting one he likes. This is enough to call Chiles *independent*, but not *(I)*. The graphic on p. 8 of that issue is based on national income accounts data that appear in Survey Of Current Business.

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VOLUME 10 ISSUE 9

STATE POLICY REPORTS

IN THIS ISSUE

State finances are in worse shape than suggested by the governors' budgets and legislative actions. Particularly in the large states, budgets have been overtaken by bad news on both revenues and spending.

- State Finances, Worse Than They Seem p. 2
- How Bad Are State Fiscal Conditions? p. 4

Many states have been reducing deficits in the current year by increasing spending and reducing revenue in the next. California and Rhode Island are now trying to deal with the results. Most of Michigan's large shortfall will be shifted to future years rather than handled by spending cuts or tax increases.

- Cascading Fiscal Problems p. 9

Blaming state fiscal problems on the federal government is popular, but increases in federal grants have killed the argument that federal aid is declining. State and local officials are cutting their recession-induced deficits. Federal officials aren't.

- Declining Federal Aid? p. 13
- Federal And State Deficits p. 14

States are finding many ways to use federal Medicaid grants to provide budget relief.

- The Medicaid Bailout? p. 16

The problem is delivering tax cuts and new initiatives with no money for them. The solution is sometimes to promise future delivery.

- Promises, Promises p. 20

Information on state finances is often conflicting, and clearly insufficient to support newly published rankings of state fiscal stability. Technical notes detail sources and other caveats.

- Measuring State Finances p. 22
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May 1992 (First Of Two May Issues)

STATE FINANCES, WORSE THAN THEY SEEM

> *The state's budget is being shored up by a series of one-time revenue "enhancements," including the use of the entire rainy day fund and transfers to the general fund from other state funds. Nothing has been done, or is currently underway, to put the FY 1998 budget back into balance. Unless the legislature comes up with a permanent tax increase, draconian budget reductions appear to be the only remaining alternative....*
>
> *{This observer} is betting on a permanent tax increase enacted by a lame duck legislature. ... If Republicans gain control of the House, Democrats who control it might very well choose to wait and let the new Republican leadership deal with the problem in January.*

This comment from a former legislative fiscal officer in Ohio reflects the increasingly serious fiscal problems being recognized in the larger states. It also reflects insider assessments that legislators are finessing problems until after the 1992 elections. It raises the possibility of **major tax increases in lame duck legislative sessions** late this year. Resolving recession-induced election-year fiscal problems by post-election tax increases was popular in the early 1980s. In 1982, five states followed this path. Most states increased taxes then or early in their 1983 sessions.

Fiscal Problems Crowding Out Other Issues

Fiscal problems are now causing a moratorium on new money-using state initiatives. In many states, the debate is concentrating on how much to trim and how to postpone previously adopted initiatives. Where decisionmakers insist on major new initiatives, they are being enacted with delayed implementation, presuming future fiscal conditions will be better.

Many legislative sessions are evolving like this issue of **Reports**. The original plan included dealing comprehensively with such issues as education reform, employee compensation, and broadening health insurance coverage. The outcome is mostly a discussion of fiscal problems and choices. The issues in education, health, and other fields shifted from major policymaking to arbitrary choices such as deferrals, freezes, and borrowing to avoid deeper spending cuts.

While some might expect fiscal problems to produce an outpouring of actions to reduce spending, not much of this is happening either. Many cost-cutting choices entail heavy front end costs and/or unpopular election-year decisions that, like resolution of fiscal problems, are often being deferred until after November.

How The Problems Developed

The fiscal problems are unfolding just about as predicted by experts, such as in the January "Red Ink Issue" of State Budget & Tax News. The results from FY 1991 were worse than expected in the calculations underlying the FY 1992 budgets. This carried lower-than-expected balances into FY 1992. Many of the FY 1992 budgets were based on an economic recovery that didn't materialize and on spending projections that are proving optimistic. These problems from FY 1992 and a sluggish economy sour the FY 1993 outlook, particularly in states that avoided tough decisions to curtail spending or raise taxes.

There isn't new bad news about state economies. But the old bad news is just working its way into revised estimates. In many cases -- such as California, Illinois, and Ohio -- this means the premises on which governors based their January budgets are now incorrect. Revenue estimates in both the budgets and the new financial plans assume resumed prosperity, but the revisions will reflect a lower base for the FY 1993 growth.

California is an example, though its numbers are larger and its problems worse than most states'. Last summer, California leaders adopted spending restraint and tax increases to close a budget gap of $14 billion. When the governor submitted his budget in January, there was a new gap of $5 billion or so, which his proposals were designed to close. In April, the governor announced the shortfall was likely to be $9 billion. This is terrible news for legislators and the governor, whose popularity in public opinion polls is already at record lows. Many of the~~m are trying~~ to avoid: (1) tax increases, (2) violating the constitutional mandate for education funding, and (3) bitter, and vote-losing, partisan disputes. They may be forced into all three.

The good times have stopped rolling nearly everywhere as fiscal problems reach the states that previously avoided them. The growth rate in the best-performing state economies has slowed -- bringing problems to states like Hawaii, Nevada, and Washington. Oil prices and declines in oil and gas drilling have created major problems for Alaska and Wyoming and pressured budgets in states like Kansas, North Dakota, Oklahoma, and Texas. States with strong reserves have been depleting them.

The responses have been uneven. In the Southeast, strong laws and traditions favoring mid-year corrections to keep balanced budgets led to proration of spending in Alabama, Arkansas, and other states. Governors clamped down administratively to cut major items like school aid in Florida, Georgia, and Mississippi. Legislatures acted in special session in Georgia and Florida. But in the Northeast and California, little happened. In a few situations, like Illinois, leaders held a posture of rejecting the message of the fiscal doomsayers. In others, particularly California and New York, governors urgently called for legislative action, but didn't get their wishes.

HOW BAD ARE STATE FISCAL CONDITIONS?

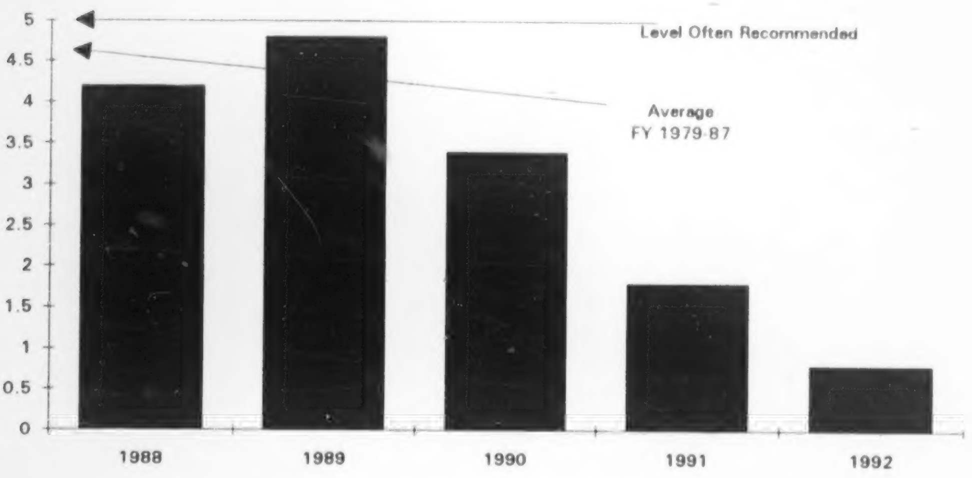
> *The fiscal condition of states continues to be very weak. ... Clearly, the downturn over the past two fiscal years, 1991 and 1992, has left major scars on state finances.*

These discouraging words begin the Fiscal Survey Of The States released in late April by the governors (NGA) and state budget officers (NASBO).

Balances Are In Terrible Shape

The states have rapidly depleted their balances. The chart shows the steady decline from FY 1989 to 0.8% of spending predicted for the combination of rainy day funds and regular balances at the end of FY 1992 (this June in 46 states). That level is well below the 5% target recommended by some fiscal experts. Achieving that target would require balances of $15.4 billion at the end of FY 1992. Instead, balances are expected to be only $3.3 billion ($325 million in regular balances and $2.2 billion in rainy day funds).

State Balances At End Fiscal Year
As Percentage Of Year's Spending



These projected balances are below the average from FY 1979 and FY 1987. The balances are also below the 1.5% hit at the end of FY 1983, the last time state finances were devastated by recession. NASBO members don't expect much improvement, with the projections for FY 1993 reaching only 1% on the expectation of resumed economic growth.

Projected balances can easily be eroded. In October, NASBO's survey showed the enacted FY 1992 budgets had estimated year-end regular balances of $4.1 billion. From then to April, the number dropped nearly $4 billion despite many budget cutting actions. The causes -- higher-than-expected spending and lower-than-expected revenues -- are continuing to take their toll.

Individual State Balances Vary Widely

The national totals conceal the large variations illustrated by the table.

Total Balances Ending FY 1992, Selected States ($ millions)

State	General	Rainy Day	State	General	Rainy Day
Alaska	$177	$639	Nebraska	$141	$27
California	-1,344	0	New Jersey	403	0
Hawaii	382	0	Oklahoma	216	186
Indiana	52	325	Oregon	290	0
Michigan	-785	194	Texas	-428	164
Minnesota	256	0	Washington	-98	260

The table below relates balances to spending. Corrective actions will eliminate or at least shrink the negative numbers, but often just by shifting the problems to FY 1993.

Total Balances As A Percent Of Expenditures, End FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	28.1%	18	Colorado	2.7%	34	Virginia	0.4%
2	North Dakota	15.3	19	Idaho	2.6	35	Maryland	0.2
3	Hawaii	13.8	20	Mississippi	2.2	36	Arizona	0.1
4	Oklahoma	12.6	21	Washington	2.1	37	Alabama	0.0
5	Nebraska	10.9	22	South Carolina	1.8	38	Arkansas	0.0
6	Oregon	10.8	23	Wisconsin	1.8	39	Connecticut	0.0
7	Wyoming	9.6	24	North Carolina	1.3	40	Georgia	0.0
8	Delaware	8.7	25	West Virginia	1.2	41	Louisiana	0.0
9	Indiana	6.5	26	Kentucky	1.1	42	Maine	0.0
10	Kansas	5.0	27	Missouri	1.1	43	New York	0.0
11	Utah	4.5	28	Illinois	0.9	44	Pennsylvania	0.0
12	Nevada	4.3	29	Massachusetts	0.9	45	Ohio	-0.1
13	Minnesota	3.9		**United States**	**0.8**	46	New Hampshire	-0.6
14	New Mexico	3.5	30	Florida	0.6	47	Texas	-1.5
15	South Dakota	3.5	31	Iowa	0.5	48	California	-3.1
16	Montana	3.1	32	Rhode Island	0.5	49	Michigan	-7.5
17	New Jersey	2.8	33	Tennessee	0.4	50	Vermont	-7.7

Few states show normal late 1980s patterns: balances in rainy day funds (in the states that use them) and significant reserves. Instead, the table shows healthy fiscal situations at the end of FY 1992 in just a few states (e.g., Indiana, Minnesota, and Nebraska). There are many extraordinary situations including some unusually large balances (e.g., Alaska, North Dakota, and Hawaii) and some negative balances (e.g., California, Michigan, and Vermont). There are only seven states in the 3-5% range. In most years, many more states have been in this range.

Spending Exceeds Revenue In Most States

State budgets are defined as balanced if *resources* available to finance them exceed spending. On this basis, NASBO's survey shows state budgets are balanced in FY 1992 in the aggregate. But if balance means financing current spending with *current revenue*, the budgets aren't balanced because nearly $4 billion of spending is being financed by drawing down balances. This test of whether budgets are balanced was used to construct the table below. It shows bad news for most states. Nationwide, states expect to spend 1.2% more than revenues, with only 19 states covering current spending with current revenue.

Excess Of Revenues Over Spending As Percent Of Spending, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	3.3%	18	South Carolina	0.0%	34	South Dakota	-1.9%
2	New Hampshire	3.0	19	New Mexico	0.0	35	Rhode Island	-2.0
3	New Jersey	2.8	20	Iowa	-0.1	36	Nevada	-2.1
4	Vermont	2.3	21	Missouri	-0.1	37	Nebraska	-2.2
5	Colorado	2.2	22	Mississippi	-0.2	38	Kentucky	-3.1
6	North Carolina	1.3	23	California	-0.2	39	West Virginia	-3.3
7	Hawaii	1.3	24	Maine	-0.2	40	Oregon	-3.3
8	Oklahoma	1.2	25	Delaware	-0.5	41	Idaho	-3.4
9	Virginia	0.4	26	Utah	-0.5	42	Minnesota	-4.6
10	Maryland	0.2	27	Georgia	-0.9	43	North Dakota	-6.5
11	Tennessee	0.2	28	Massachusetts	-0.9	44	Texas	-6.6
12	Illinois	0.1	29	Indiana	-1.0	45	Washington	-7.4
13	Wisconsin	0.1	30	Ohio	-1.1	46	Michigan	-7.9
14	Alabama	0.0	31	Arizona	-1.1	47	Montana	-8.3
15	Arkansas	0.0		**United States**	**-1.2**	48	Louisiana	-9.4
16	Connecticut	0.0	32	Florida	-1.3	49	Wyoming	-11.2
17	New York	0.0	33	Kansas	-1.5	50	Alaska	-21.5

The top states are experiencing boosts in revenue from tax increases (New Jersey and Pennsylvania) or windfalls from Medicaid payments (New Hampshire). Many of the negative numbers are associated with slumping oil and gas revenues as well as deliberate draw downs of balances built up for exactly the contingencies being experienced this year. Examples are Indiana, Kansas, Minnesota, Oregon, and Washington.

Revenues Generally Below Estimates

A major portion of the problems being encountered this year is attributable to revenues not performing as well as expected when budgets were enacted. Only a few smaller states reported revenues above expectations. Nationwide, sales taxes revenues are falling about $2.5 billion short, personal income tax revenues are off about $3.3 billion, and corporate income taxes show a shortfall of $1.4 billion. The range of error is from an underestimate of nearly 15% to an overestimate of nearly 7%.

Change From Estimate
Sales Tax, FY 1992

Rank	State	Percent
1	Massachusetts	14.6%
2	Minnesota	0.6
3	Missouri	0.2
4	North Carolina	0.0
5	Texas	0.0
6	Louisiana	-0.1
7	Wisconsin	-0.3
	Unlisted States	**-0.5**
8	Tennessee	-1.1
9	New York	-1.5
10	Pennsylvania	-1.6
11	Kentucky	-1.9
12	New Jersey	-2.0
	United States	**-2.4**
13	Indiana	-2.5
14	Arizona	-2.5
15	Ohio	-2.7
	Listed States	**-2.7**
16	Arkansas	-2.8
17	Connecticut	-3.0
18	Washington	-3.0
19	Michigan	-3.6
20	South Carolina	-4.2
21	Illinois	-4.2
22	California	-4.9
23	Maryland	-4.9
24	Florida	-5.8
25	Georgia	-6.0
26	Virginia	-6.7

The table shows the difference between the original estimate of sales tax revenues, in the states with $1 billion or more such revenues, and the estimate current when the states responded to the NASBO survey this spring.

The **Massachusetts** results are an error in state estimates, not in reporting. Before the FY 1992 budget was enacted, many observers said the estimates were way out of line, as they now appear to be -- bearing little resemblance to the direction of error (overestimates, not underestimates) and the magnitude of error (0-4%) in other Northeastern states.

The largest percentage errors appeared in the Southeast, particularly in **Florida**, **Georgia**, and **Virginia**. The **California** error of 4.9% is indicative of shortfalls experienced in all of the state's major revenues. The shortfalls were generally smallest in the less populated Western states, those shown as "unlisted" on the table.

NASBO calculates that overall state tax collections are running about 3% below the original estimates used in the 1992 budgets. As a result,

> *Unless other revenues offset these decreases, states are forced to reduce their enacted budgets or use reserve funds to balance FY 1992 budgets.*

These shortfalls are associated with over $5.7 billion of cuts NASBO counts as having been made after the FY 1992 budgets were passed. But the cuts were insufficient to offset the poor revenues, so the drawdown of balances has been automatic in many states.

Spending Exceeding Projections

> *We're continuing to hear bad news from the states because they are not only seeing slower growth in revenues but they are also continuing to see an explosion in cost for health care, corrections, and social programs like welfare.*

The scissors cutting state finances to shreds have two blades. One is recession-depressed revenues. The second is spending growth, summarized in the quote from NGA's executive director as he described the latest fiscal survey. In the aggregate, the factors increasing spending over estimates have overwhelmed decisions to reduce spending. The results appear in the evolution of spending estimates in the Fiscal Survey.

Total General Fund Expenditures ($ billion), Successive NASBO Surveys

Survey Issue Date	FY1991	FY 1992	FY 1993
April 1991	$288.0	$296.6	n/a
October 1991	287.2	301.5	n/a
April 1992	292.5	307.0	318.0

While there are some signs of relief from persistent underestimates of corrections costs, Medicaid costs may again outrun the amounts budgeted for FY 1992. The desire to adopt apparently balanced budgets while avoiding tax increases gives strong incentives to underestimate Medicaid spending in the FY 1993 budgets as well.

The Outlook Is Poor

State revenues have been performing poorly so far in FY 1992. The latest report from the Center for the Study of the States shows tax collections in the October-December quarter up 6.3% from the previous year. However, 5% was associated with tax increases while only 1.3% was associated with inflation and changes in economic activity. Personal income tax growth was strongest at 8.9%, but only 3.9% was associated with economic changes and the rest with rate hikes. Sales taxes, without rate changes, would have increased 0.9%. With them, the increase in revenue was 5.9%.

Slow revenue growth is seen for FY 1993. The NASBO survey projects that FY 1993 state general fund revenues will be $318.8 billion, up $16.6 billion from revenues expected in FY 1992. However, this increase includes about $5.1 billion from tax increases recommended by the governors. Without them, the revenue increase would be about 4% -- barely enough to beat projected inflation.

The revenue situation as elected officials see it unfold is much less pleasant than projected increases alone suggest. **Much of the projected revenue increase is needed to offset shortfalls.**

The sales tax estimates provide an illustration. In the new budgets nationwide, elected officials are being told that sales tax revenues (without new tax increases) will rise from $101.3 billion in FY 1992 to $106.1 billion in FY 1993. This projected increase of about 5% reflects the economic recovery generally being predicted for FY 1993 and is well above the predicted inflation rate. However, the FY 1992 sales tax revenue estimate that legislators used in developing the FY 1992 budgets wasn't the current FY 1992 estimate, but a higher $103.8 billion. So the increase in FY 1993 over *what legislators thought they had for FY 1992* is only 2%.

Put another way, without tax rate adjustments, legislators would have to apply sales tax revenue growth of $4.9 billion: (1) $2.5 billion to plugging the shortfall in FY 1992 revenue and (2) $2.4 billion to finance FY 1993 spending growth. This example, with half of this year's revenue growth needed to plug last year's shortfalls, is typical of many situations throughout the country. Uncured budget problems from one year automatically slide into the next.

CASCADING FISCAL PROBLEMS

FY 1993-

The chickens come home

to roost

The **Rhode Island** budget office used this graphic late last year to brief legislators on the problems likely to result from past actions to defer fiscal problems, actions that covered nearly 10% of the budget. In Issue 2, **Reports** used it and an assessment by the legislative staff in **California** to show how fiscal problems in the new budgets would develop out of the easy solutions of the present one.

FY 1993 Problems In Two States

These situations, and others like them, are playing out as badly as expected. In **California**, the problems are so severe that both the governor (R) and legislative leaders (D) have avoided proposing comprehensive solutions out of fear that unless they act jointly (which they show few current signs of doing), the first to act may well be shot as the messenger bringing the bad news.

In **Rhode Island**, the governor has a solution that would appear to balance the budget but at a price: (1) all "temporary" tax levels remain in effect, (2) sales taxes are increased by broadening the base, (3) various revenues are accelerated, (4) the medically needy portion of Medicaid is eliminated, (4) school aid is basically frozen, (5) local aid is cut to about a fourth of the level in FY 1988, (5) other funds are tapped to bail out the general fund, (6) general assistance payments drop and eligibility is reduced, and (7) similar changes in other programs and revenue sources.

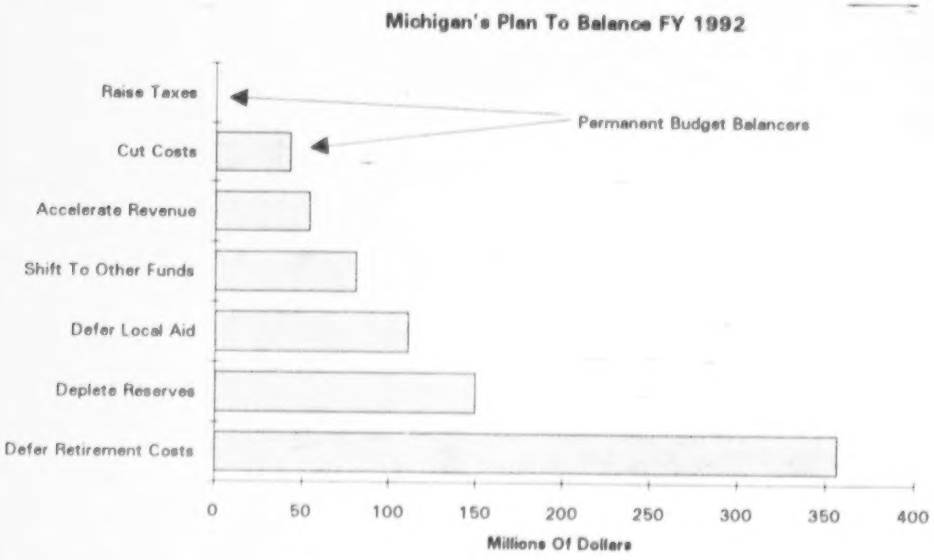
Dealing With FY 1992 In Michigan

The Painless Plan: The situation in FY 1993 is most severe in those states that still haven't solved their FY 1992 problems. Michigan (with a fiscal year beginning in October) is a classic case of both what can be done to avoid tax increases and the hazards for future year state finances. The FY 1992 budget now has an admitted shortfall of about $800 million, nearly 10% of the general fund. In mid-April, the governor issued his plan to close the gap. He told legislative fiscal panels that the plan "balances the budget and protects education" with no new taxes. Furthermore, "essential services are maintained, with no cuts in social services or public protection programs." The budget director assured legislators that most Michigan residents would be unaffected by the spending cuts.

Prefunding Retiree Health Costs: Among other things, the governor proposed a change in the method of funding health care costs for retirees designed to "save" $188 million. Most states pay these costs as they go along. However, they clearly are akin to retirement cash payments, so under generally accepted principles now being applied to the private sector, their costs should be recognized during employees' working years. Only a few states besides Michigan (Kentucky, New Jersey, New Mexico, and North Dakota) do this. Moving Michigan to pay-as-you-go financing would avoid the other choices he offered: (1) cutting school aid by 20%, (2) raising the personal income tax by 11%, or (3) cutting welfare benefits "to levels in Arkansas," plus cutting school aid by 8%.

Deferring 95% Of The Problem: This plan was only one of the ways the proposal avoids major spending cuts and tax increases. By repackaging it, **Reports** produced the chart on p. 11. It reflects only $43 million of spending cuts and no tax increases in gap-closing measures of $796 million. The $43 million includes reductions in building maintenance, postponing equipment purchases, and other items that might be considered spending deferrals. The chairman of the Senate Appropriations Committee said he had a "conscience problem" with some of the one-time measures. The budget director agreed that they are "not ideal," but argued they were better than the alternatives.

The spending cuts were dwarfed by supplemental appropriations that added to FY 1992 spending and increased the budget gap. They included over $100 million for schools to cover a Michigan pattern of underestimating school foundation payments, $24 million in other education programs, and $15 million for other agencies.



Legislative action is more likely to increase, rather than reduce, the extent to which shifting problems to future years is used to resolve the FY 1992 budget gap. There is opposition to some of the spending reductions which the Lansing State Journal (4/17) described as "modest." There is interest in the legislature in committing the entire rainy day fund to filling the gap, rather than just using most of it as the governor proposed.

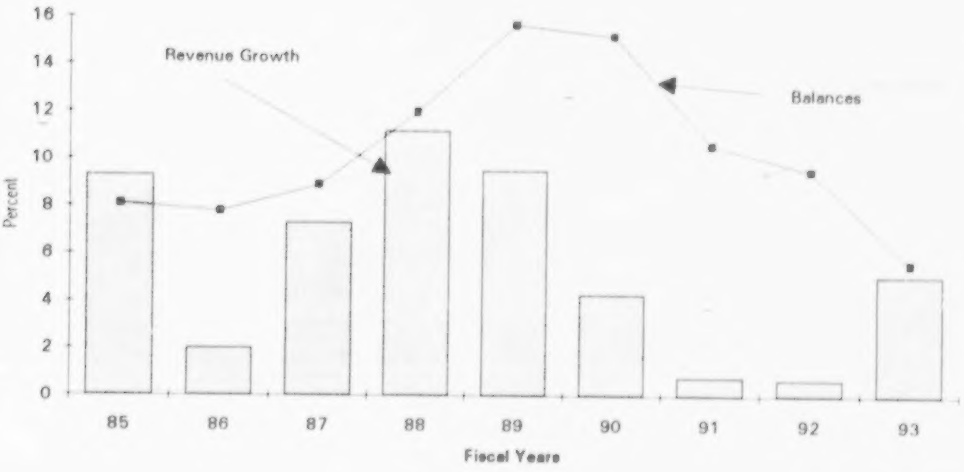
Carrying Problems Into FY 1994

Even when state finances appear comparatively good, they can be considered bad. **Indiana** has managed its finances as experts recommended to state officials seeking to avoid sharp tax hikes or spending cuts when unfavorable contingencies, such as recession, occur. As a result, it hasn't made major changes in taxes and has handled spending by limiting increases, not making cuts. This conclusion has appeared previously in SB&TN and has resulted in Governor Bayh (D) getting high marks from the conservative CATO Institute in a recent ranking of governors' fiscal policies (see Issue 6).

The governor likes to brag about these assessments, to the consternation of some Hoosiers. One of Bayh's critics, Senator Mills (R), chairs a key fiscal subcommittee. He has protested vociferously at 12-page length to the Wall Street Journal (for publishing the CATO rankings) and to SB&TN. His concerns are not consistent: (1) "Clearly, Indiana is on a crash course to hit the fiscal fan." and (2) Governor Bayh is getting credit belonging to prior governors (R) and legislators (R).

By accident or design, Indiana's fiscal strategy has closely conformed to the recommendations of many reports written in the aftermath of state fiscal problems in 1982 and 1983. They recommended building reserves in good times, particularly when revenue exceeds estimates, and protecting some of the resulting balances as budget stabilization or rainy day funds. Indiana did this as shown on the chart.

Indiana's Fiscal Profile
Percentage Of Revenue



Balances were built in the prosperous late 1980s. When revenue growth dropped below 6%, the Indiana average, balances were drawn down. The balances didn't have to replace all of the revenue shortfall because spending growth was held below 6%. To constrain spending, Indiana resorted to measures recently used by many states. Debt financing was used for many capital outlays. Lottery proceeds were shifted from earmarked uses to support of the general fund. Payments to local governments were deferred.

The net effect of all these measures has been to permit enactment of balanced budgets without new taxes and without painful spending cuts. As calculated by the Indiana Fiscal Policy Institute, the result is the pattern shown in the table.

As it moves to FY 1994 issues in next year's legislative session, Indiana has a problem even if its assumptions all work out. To continue in FY 1994 all of the expenditures financed by one-time items in FY 1993 would require all of its 6% normal revenue growth. If it retains its diversions and delays, it would still have to devote over half of normal 6% revenue growth to funding what was funded with reserves in FY 1993.

Indiana's Budget-Balancing Measures, FY 1991-FY 1993 ($ million)

Category	FY 1991	FY 1992	FY1993
Spending Without Accounting And Timing Changes	$5,812	$6,137	$6,311
Spending Reductions	0	65	55
Use Of Reserves (Net)	276	81	223
Delay In Local Aid Payments	0	293	10
Diversion of Lottery Revenues	0	120	160
Percentages Of Spending			
Real Spending Cuts	0%	1.1%	0.9%
Delay and Diversion	0	6.7	2.7
Reserve Drawdown	4.8	1.3	3.5

Thus, a state that managed its way through recession more or less "by the book" faces future problems. Indiana's situation will be even worse if recession doesn't end on schedule. It wouldn't get the revenue growth anticipated to be 5.1% in FY 1993 and more in FY 1994. Other states that haven't raised taxes have comparable problems. In Wisconsin, the budget for FY 1993 contemplates drawing down balances, one-time revenue, and spending deferred into FY 1994. Minnesota and Virginia are also examples.

DECLINING FEDERAL AID?

State and local officials have been attributing fiscal problems to federal cuts since the rapid growth in federal aid slowed late in the Carter Administration. The concerns were particularly strong in the early 1980s after the Reagan Administration discouraged growth in many programs and cut back or eliminated others. Given this history, the discussion of federal aid in Issue 7 was bound to disturb some state and local officials. It did.

That discussion showed federal grants increasing from 1990 to 1991 by 17.4% while state and local tax revenues were growing about 5%. Since it was published, the Commerce Department has estimated that federal grants in 1992 are likely to increase "nearly 20%." Total state and local receipts in the same period are likely to about match the 6.5% increase in CY 1991, so state and local receipts from their own taxpayers will again increase at a third or less of the increase in federal grants.

The notion of *federal cuts* has never been supportable in terms of current dollar outlays. In 1992, federal grants to state and local government will be about $182 billion, up from $103 billion in 1987, $89 billion in 1980, $55 billion in 1975, and $24 billion in 1970. So the case for *cuts* depends upon a concept of what federal aid *should have been.*

One approach is to pick a base year and presume aid should grow from that base to match inflation and population growth. But state and local governments increased their spending, particularly in the flush late 1980s, considerably faster than necessary to match price and population increases. For example, over the five years ending in 1992, the Consumer Price Index has increased about 24% and population grew about 6%. The increase in federal aid during the same period will be about 77%.

Not everyone agrees that state and local spending should have increased so rapidly. Not everyone agrees that if state and local officials decide on such rapid growth, there is an obligation for the federal government to match it and that failure to do so is a *cut* in federal aid. But presuming that federal aid should share proportionally in financing the increase has been an integral portion of the case for *declining* federal aid for years. By this approach, one reader protested the Issue 7 article, arguing that federal aid has contributed to state and local fiscal problems.

To make this argument, the starting year must be a peak year in federal aid as a percentage of state/local receipts -- the reader picked 1977. The ending year must also be carefully selected -- the reader picked 1988. On this basis, there is a cumulative shortfall of about $200 billion, the difference between actual federal aid and what aid would have been if maintained as a constant percentage of state local receipts. The relevant percentages are 18% in 1970, a peak period of just below 23% in the late 1970s, a low of about 17% in the mid- to late-1980s followed by 18.2% in 1990, 19.8% in 1991, and an estimated 22.1% this year. Even picking the most favorable base year for comparison barely indicates a shortfall now. Sometime in 1992 or early 1993 federal aid will have matched the highest percentage of state and local receipts in history. As pointed out in Issue 7, blame for part of the current state and local fiscal problems can be placed on the federal doorstep, but the reasons don't include federal aid cuts, no matter how far one goes to define *cuts*.

FEDERAL AND STATE DEFICITS

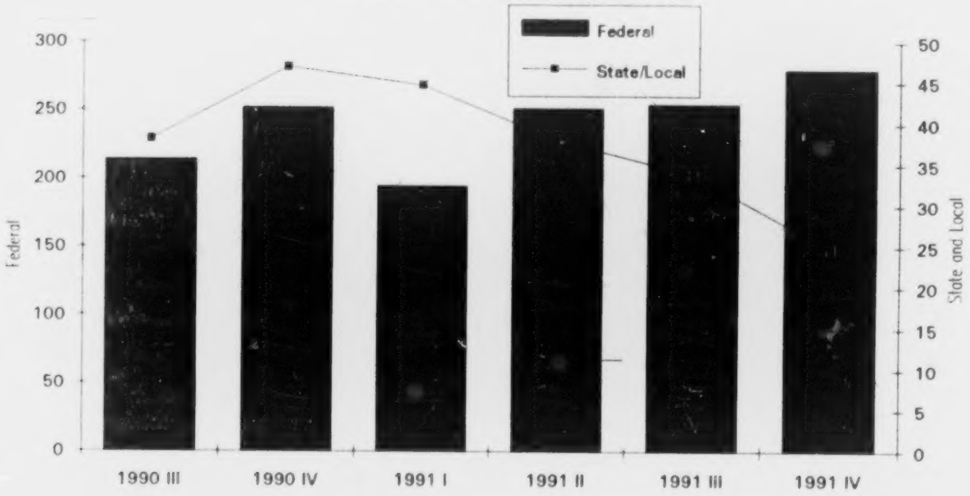
> *The single most important factor affecting the fiscal condition of states is the health of the national and global economies. ... together states have a common interest with the federal government in finding a sustainable path for the federal budget that brings federal expenditures in balance with revenues.*

As these comments in the Fiscal Survey suggest, state officials continue to worry about the impacts of a growing federal deficit on the economy and thus on state budgets. Excluding trust funds, the federal government is borrowing to finance 20% of its spending. State and local governments cover about 3% of their spending by borrowing, mostly bond issues for long-term capital outlays.

Federal borrowing is not differentiated by whether it supports capital or operating costs, but any method of calculation suggests it mostly funds an operating deficit. The federal government pays net interest of nearly $200 billion a year while state and local governments *collect* about $60 billion. Interest they earn exceeds interest they pay.

The battle for federal deficit control is not going well, as suggested by the columns in the chart. These quarterly deficit levels are projected to grow in 1992, but may start to decline somewhat in mid-1993 *if* the assumptions of the President's budget are achieved.

Trends In Government Deficits
($ billion, excluding trust funds)



The chart shows that both levels of government are responding to recession in classic fashion. As recession develops, deficits starts to rise. The federal deficits remain large through inaction permitted by deficit financing and because many decisionmakers seek economic stimulus from an excess of spending over revenues. Balanced budget requirements force quick state and local adjustments, including some overcorrection to restore lost reserves. This results in rapid reduction of their deficits at the expense of policies, such as layoffs and tax increases, that contribute to recession.

The adjustments were probably most rapid in local governments. They are appearing in the state data as well as states run out of rainy day funds and other balances with which to finance spending in excess of revenues and the few states that borrow for operating costs seek to repay that debt, or at least prevent its increase. The NASBO survey shows deficits in state general funds of $6.2 billion in FY 1991, $3.8 billion in FY 1992, and a projected $0.9 in FY 1993.

THE MEDICAID BAILOUT?

Medicaid costs have been a massive burden for state finances, one magnified by mandates of coverage, litigation on reimbursement rates, and federal laws and regulations that cut off nearly every avenue of state escape from double-digit cost increases. The effects have included state taxes higher than they would otherwise be and less funding for state priorities, particularly education, than would otherwise have been the case. Proofs of these statements are constantly unfolding in every state and in **Reports**.

This said, **Medicaid is bailing many states out of fiscal problems.** In theory, state costs and federal aid have been growing in lockstep at double-digit rates to reflect: (1) more recipients because of demographic changes and economic problems, (2) recipient growth caused by mandated increases in coverage of pregnant women and young children, (3) general inflation, (4) health care inflation exceeding general price increases, and (5) expanded services reflecting new technology, defensive medicine, and other factors. In practice, state general funds aren't absorbing all these pressures. Some are getting bonuses from Medicaid financing that free resources for other uses. The phenomenon isn't easily quantified, but anecdotal evidence is becoming overwhelming.

There is big money in disproportionate share payments and retroactive claims. This money was big enough so that the "windfall" was credited with saving Massachusetts from deficit. In New Hampshire, knowledge that the money was coming turned a debate over whether to enact a personal income tax or substantially increase taxes on business into a decision that neither was necessary. In Rhode Island, the extra money ($265 million) is known locally as a *windfall* and a *fiscal miracle*. Half is being spent for Medicaid, but half is the equivalent of unrestricted revenues, like revenue sharing. It is being used to unwind borrowing from a state authority, replenish the rainy day fund, and move some school aid payments deferred into FY 1993 back into FY 1992. If the per capita windfall in all states were the same as Rhode Island's, the national fiscal relief would be $33 billion.

There is big money in aggressively establishing Medicaid eligibility for clients and facilities now funded with 100% state and local money. There are many institutional reasons why some services are 100% paid with in-state resources when they are eligible for Medicaid coverage. It has long been argued that public hospitals are insufficiently motivated to seek reimbursement because public subsidies cover their losses. This has been one of the arguments behind the shift of Mississippi's state hospitals and many county and city hospitals to the private and quasi-private sector.

These arguments apply to state mental institutions, residential facilities for the retarded, and veterans' homes. Many of these facilities would have to be upgraded in physical plant and staffing to qualify for Medicaid. Tight budgets and the possibility of shifts to community programs have discouraged these investments despite the substantial Medicaid payoff.

An alternative to upgrading state facilities is to increase efforts to shift patients from institutional settings to purchased community and residential care. Medicaid reimbursement motivated such moves in Massachusetts, among other states. Many patient advocates and mental health professionals have long sought such changes on therapeutic grounds alone.

Other shifts are small, subtle, and impossible to quantify. For example, St. Louis leaders are debating shifting certain maternal and child health functions from the city's health agency to the city-county hospital. One argument for the change is increased Medicaid reimbursement. Public health agencies, like city and county health departments, are oriented to providing service to all comers free or at nominal cost. They probably aren't aggressive or skilled at establishing clients' Medicaid eligibility or at keeping the books and doing the paperwork for Medicaid. Hospitals have this experience and motivation.

If costs of service remain the same, every dollar's worth of Medicaid service means 50 cents less state and local spending in the most affluent states. More savings are available in states where the federal cost sharing percentage exceeds 50%, as shown on the table.

Projected Federal Share Of Medicaid Costs, FY 1994

State	Percent	State	Percent	State	Percent
Mississippi	78.64%	South Dakota	68.06%	Ohio	60.32%
West Virginia	75.85	Tennessee	67.47	Vermont	60.29
Utah	74.77	Arizona	66.68	Wisconsin	59.97
Arkansas	73.97	Wyoming	65.91	Kansas	58.09
New Mexico	73.57	North Carolina	65.90	Michigan	56.30
Louisiana	72.99	Texas	63.93	Florida	55.40
South Carolina	71.05	Indiana	63.11	Pennsylvania	55.16
Kentucky	71.02	Georgia	62.57	Minnesota	54.72
Alabama	70.93	Maine	62.11	Rhode Island	54.64
Idaho	70.53	Oregon	61.98	Washington	54.20
North Dakota	69.69	Iowa	61.85	Colorado	54.02
Oklahoma	69.40	Nebraska	60.94	Nevada	53.22
Montana	69.28	Missouri	60.51	**All Others**	**50.00**

Bootstrap financing is still working. The compromise federal legislation enacted late last year was designed to halt the burgeoning use of bootstrap financing. The price paid by states was to lose this source of potential future revenue. But to make it feasible of enactment, it immunized state practices in effect in FY 1992 for that fiscal year, longer in some cases. It also closed the d~~oor on fede~~ral attempts to declare any past financings invalid and opened the door wide for states proceed to the limits allowed by the new legislation.

The states are clearly taking advantage of these provisions, though no one has a count of how many or how much financial gain.

Provider taxes are proving popular. The states, particularly ones that used provider "donations" to finance Medicaid state contributions, are adopting financing arrangements permitted by the new federal legislation. The most popular one is a tax on health care providers, particularly hospitals. It is based upon measures of gross activity, whether covered by Medicaid or not, such as gross revenues or bed-days.

There is substantial state ingenuity in these arrangements. The counsel of West Virginia's tax agency recently described that state's new levy as a tax of 23% of Medicaid billings. Viewed this way, an added $100 in Medicaid spending results in: a $77.68 federal payment under the FY 1992 cost sharing percentage and a state outlay of the remaining $22.32. The added state tax revenue of $23.00 is enough to cover the entire state share of the added payment with money left over for administrative costs. This would make added costs from higher reimbursement rates free to West Virginia taxpayers and health care providers, which may explain why the state raised those rates. It would also tend to induce an escalation in Medicaid costs, as no one in West Virginia would have any reason to control them. The reported increase from FY 1992 to FY 1993 is 53%.

A somewhat less extreme case is developing in Tennessee, one of the states being forced to eliminate its donation program. The plan recently approved by the Tennessee Hospital Association would fund all Medicaid spending with 70% of the money coming from the federal government, about 13% from the state, and about 17% from the providers. Hospitals have agreed to pay $358 million with another $36 million to come from nursing homes. A gap of $60 million is yet to be filled. The Tennessee Medical Association alerted its members to the possibility of a fight against raising $21 million from doctors with a tax that would average $4,000 per year each.

In cases like Tennessee's, the state may be paying 13% of all Medicaid costs, but not necessarily 13% of any increases. One possibility is to increase reimbursement rates for doctors with 100% of the increase paid for by the doctors. The higher rates might increase the number of participating providers, as it did in West Virginia where 750 more doctors and dentists signed up to take Medicaid patients after rates were raised. The added costs would come 70% from the federal government and 30% from doctors' pockets. No one can predict (or audit after the fact) how the money will get into doctors' pockets. Lower compensation to doctors is a possibility, but higher Medicaid charges are a better bet. Non-Medicaid patients will lose to the extent that the provider taxes are passed along to them. They will gain to the extent they are relieved of cross subsidies for low Medicaid reimbursement rates and non-paying patients.

Windfalls are appearing in federal numbers. The March Survey Of Current Business reports calendar year federal Medicaid spending up 21.5% in 1990, 32.4% in 1991, and estimates an increase of 33% in 1992. These numbers suggest windfalls, as they are well above the Medicaid increases in state budgets. With constant cost sharing ratios, the increase in federal spending must be matched by an equal increase in state spending.

The 32% and 33% increases aren't reasonably related to underlying costs. Private health insurance faces the same general inflation, extra health care inflation, and growth in services-per-patient faced by Medicaid. Private plan cost increases were about 13% in 1991. Medicaid could show larger increases because of recession-related growth in recipients and extraordinary reimbursement rate changes because of Boren Amendment litigation. Assuming special factors would bring normal apples-to-apples Medicaid spending increases to 16-17%, the 32-33% estimates imply an equal amount of the Medicaid increase will be for what amounts to fiscal relief -- funding costs previously covered by 100% in-state money and retroactive claims. If only a third of the 1991 federal aid increase of 32% went for this purpose, the state fiscal relief was $5 billion.

Medicaid revenue increases aren't showing clearly in state numbers. Many states aren't treating the provider revenues from taxes and donations as general fund revenues, much less general fund tax increases. They are *not* in the tax increases reported by the Center for the Study of the States and are in NASBO and NCSL numbers only for states that elected to consider them as tax increases. Some states treat them off-budget and some apparently consider them as offsetting receipts. This can lead to reporting them as spending cuts rather than tax increases, as New York officials did in their new budget.

Look for confusion and chaos in Medicaid finance. Federal officials aren't in a good position to change the ground rules before 1993. Because this subject was recently addressed by legislation, further administrative action would be awkward even if there were no politics involved.

Politics is involved, making it hard for the Bush Administration to constrain new state financing methods before the elections. The Administration was criticized for extraordinary aid to New Hampshire at the time of the Republican primary, making it embarrassing to deny similar Medicaid treatment to other states. The Administration is likely to be attacked for not doing enough in health care for the poor. Expanded Medicaid was the President's response in 1988 and may well be part of the response in 1992, making a confrontation with state officials over cutbacks important to avoid. Finally, the Medicaid solution helps some key Republican governors who are trying to avoid tax increases.

The Congress is likely to avoid controversial legislation in any field before elections. Because the budget control legislation treats Medicaid as an entitlement protected from control and competition with other spending, there is no built-in motivation to worry about sharply escalating cost except general concerns with the federal deficit.

In this environment, state officials face a large open door to the federal treasury. That door will probably close as similar doors to 100% federal cost sharing (e.g., special education, mass transit operating costs, and social service grants) have closed.

The argument for rushing through the door -- with as much provider financing as possible, liberal Medicaid eligibility and services, and higher provider reimbursement rates -- is the immediate benefit to a state's economy, budget, and the health of its people. If any controls subsequently enacted contain hold harmless provisions, another argument for going through the door is that it could be closed to states not acting. Conversely, it is easy to envision scenarios where states become committed to extremely expensive Medicaid policies only to watch the federal support that encouraged them disappear.

Federal regulations to implement last year's legislation haven't yet been issued. It is difficult to predict when they will be.

PROMISES, PROMISES

Faced with difficulties in passing appropriations calling for increased spending or reduced revenue, **legislatures are passing more tax reductions and spending increases with future year impacts.** They may never be implemented.

Doing something today for which costs will not appear until tomorrow is not a new idea. Some mechanisms are common and reasonably respectable, such as financing capital outlays by borrowing and passing stiffer sentencing laws without budgeting for increased corrections costs. Another time-honored practice is *letting the camel's nose under the tent.* {The argument is that if you let the nose in, the entire camel will soon follow.} It is a classic argument against appropriating money for designing public works without appropriations for construction and against allowing programs to begin that inherently involve increasing costs over time. Another common case is phasing in a cost so that its full impact isn't felt until the next fiscal year. One example is budgeting a staffing increase to occur in the middle of the fiscal year, which means costs in the second year double. A pay raise effective at mid-year has the same impact.

Reimbursement programs create rights to payments in a subsequent fiscal year. These were a common device in some forms of school aid, particularly special education, and are inherent in programs in which states pay, or share in paying, deficits incurred by activities like local mass transit. These programs make spending uncontrollable and unpredictable. When 100% or nearly 100% reimbursement was involved, they also encouraged rapid spending increases. State officials couldn't control them by budget decisions because the appropriations were a reimbursement due for past activity. These devices have been eliminated from most state budgets except for entitlements like Medicaid. In a sense, revenue-reducing tax deductions and, especially, tax credits, are reimbursement programs even though no cash outlays are involved. A few states have tried to control these in the industrial development field by requiring prior authorization of spending for which a tax credit will be claimed.

Future appropriation commitments have become common, particularly in education, where the response to school equalization concerns has often been multi-year programs to provide equalization without cutting aid to any district. Also, such expensive quality measures as reducing class sizes and expanding pre-school education have often been enacted for future implementation. When the bill comes, state officials often opt to postpone the improvements, as has happened in Colorado and Georgia among other states.

Future tax cuts are also common. One version is the *temporary tax*, which is not an oxymoron, but is often little more than an aspiration. In some cases, such as the Louisiana sales taxes of the late 1980s, the temporary characteristic has lost its meaning. But in others, such as the Illinois income tax increases scheduled to expire in 1991, renewal can become an issue in campaigns. There are enough examples of temporary taxes that have been temporary to lend credence to the idea, particularly when the tax is tied to a one-time expenditure. An example was the temporary tax adopted in Missouri to handle refunds under the Davis case on equitable treatment of state and federal retirees.

Scheduled future tax reductions have a justified bad reputation. New York has been postponing its income tax reductions for years. Virginia's postponing a reduction in the sales tax on prescription drugs was just one of this year's growing number of examples.

The latest examples are comprehensive approaches to health care financing that appear unlikely to be implemented. The granddaddy was the Massachusetts universal care plan showcased by Governor Dukakis in the 1988 Presidential campaign. Massachusetts elected officials recoiled at the prospect of $1,000 a year per-employee taxes on employers. But the reaction came after enactment, rather than in debate over enactment. Maine adopted a less sweeping plan which is also not being implemented.

The newest plan, in Minnesota, is considerably more modest. If it works as designed it will cover just under 40% of the uninsured, will demand substantial premium payments from users in the income range of $20,000 to $40,000, will have less complete coverage than the typical large employer health plan, and will involve no payroll tax. The taxes to support it, primarily a 2% levy on health care providers, aren't scheduled to go into effect until next year. With its modest aspirations, the plan runs less risk of not being implemented, but more risk of not solving enough of the health financing problem to satisfy its sponsors. The primary risks to implementation are a combination of: (1) less voluntary participation than predicted and (2) diversion of the provider taxes to finance Medicaid in the tight fiscal circumstances predicted for Minnesota's next biennial budget.

California legislators have never been able to agree on a comprehensive health financing plan, but did conclude that cost was a major barrier preventing small employers from adopting plans. So legislation was passed to provide a tax credit that would offset 25% of the health plan costs of small employers up to $25 per employee-month.

The credit was adopted in 1988 for future effect. As the future was becoming the present, the legislature acted in 1989 to postpone the effective date to 1992. In 1991, the start date was extended to 1993. Now, as 1993 approaches, the bill to extend the date to 1994 has been reported out of committee. Prospects for passage are good as all major plans for the budget assume implementation will be postponed.

MEASURING STATE FINANCES

NCSL and NASBO agree that nine states had no tax changes in 1991. But Steven Gold asks,

> *Guess how many other states there were for which they reported the same increase or decrease?*
>
> *Would you believe one?*

Major Surveys Differ: Just about everyone would agree that the best numbers on state finances: (1) come from an objective source and (2) use the same concepts and definitions for each state. Only the Census Bureau statistics meet this test. But they are slow. FY 1990 data released last fall are the latest available for debating FY 1993 budgets. Also uniform definitions aren't always best. When a governor claims 30 other states have deficits, he wants the back-up to be 30 governors with admitted deficits, not five admitting deficits and a statistician claiming another 25 have deficits they don't admit.

The two "official" surveys of state finances, NCSL's and NASBO's, have one compelling advantage. Their numbers are verifiable by offices in individual states and the details behind them are knowable. That is, someone can explain where the numbers came from, what assumptions are involved, and what policies are presumed in them. To achieve congruence with their member's numbers, NCSL and NASBO report different numbers when the legislative and executive in individual states disagree, as they often do.

They also report inconsistently when states aren't consistent. For example, in 1991 the state tax administrators (FTA) reported that at least 29 states gained revenue from conforming to federal changes in how deductions for high income taxpayers are handled. So how many should be counted? Choices: (1) all 29, (2) the 14 FTA reports acted by legislation rather than administrative action, (3) the eight reported by NCSL, (4) the six reported by NASBO, or (5) the zero used by Gold's Center for the Study of the States. When the organizations impose common definitions, they do it differently. Extending a "temporary tax" constitutes a tax increase for NCSL, but not for NASBO, Gold, or State Budget & Tax News. The massive increases in health care provider taxes are reported as tax increases in some states and not others. NASBO and NCSL follow the inconsistencies. Gold and the Census Bureau exclude all of them. SB&TN reports them all as increases.

Conflicting Results: The table shows some extreme examples of the differing pictures of 1991 tax increases presented by the Center and the two state organizations.

Three Views of Tax Increase In 1991 ($ million)

State	NASBO	NCSL	Center
Alabama	$22	$172	$0
California	5,691	6,393	6,393
Illinois	144	732	27
Louisiana	-14	315	0
Massachusetts	-156	-215	-40
New Hampshire	0	62	39
New York	817	1,200	800
Texas	1,058	852	852
TOTAL US	$15,031	$16,320	$14,536

Pretenders To The Throne: Several groups have tried to reap the publicity of providing information, and sometimes rankings, of 50 states' finances. Their materials aren't generally used in serious forums, such as legislatures, because they do not explain where the numbers came from and how they entered any rankings in sufficient detail so that others can replicate the calculations. The Tax Foundation numbers on state tax increases are an example. So are the numbers appearing in City & State's 7th Annual Financial Report on states (4/20). Its numbers differ wildly from NASBO's. For example, NASBO reports a national total general fund balance ending FY 1991 of $3.0 billion while C&S reports $5.6 billion. For FY 1992, the comparable numbers are $4.4 billion and $0.3 billion.

Another Junk Ranking, State Fiscal Strength: The new C&S ranking of states "according to their fiscal strengths" doesn't merit much attention. The methodology can't be replicated or even reviewed because it isn't spelled out in detail and because data sources aren't clear. It will get attention, as just about any such survey does, because incumbents in high-ranked states will use it as vindication and challengers in low-ranked states will use it as justification for removing incumbents.

Not knowing exactly what "fiscal strength" is, judging the rankings is hard. One view of fiscal strength would be net worth. Winners would be states with massive reserve funds like **Alaska** (ranked #27), **Wyoming** (#5), or **Texas** (#13). High ranks would go to states with no debt (as C&S measures it) like **Iowa** (#42) and **Colorado** (#36) as well as **Nebraska** (#2) and **South Dakota** (#3). Also good is having no unfunded pension liability like **Iowa** (#42) as well as **Tennessee** (#1) and **Delaware** (#3). Bond ratings don't help much. **Maryland** (#35) is AAA as is **South Carolina** (#29). Having a large rainy day fund and general fund balances helps **Nebraska** (#2) but not **Oklahoma** (#44).

The C&S loser is **Connecticut** despite enacting a large new income tax. The winner is **Tennessee** despite nationwide publicity for near bankrupt school districts and legislative rejection of an income tax the governor insists is necessary for solvency. If the award is really given for "stability," **Reports** would award it to states resistant to changes in their fiscal patterns like **Georgia**, **Indiana**, and **Utah**, which C*S ranks between 19th and 29th.

TECHNICAL NOTES

State Finances: The Ohio quotes (slightly paraphrased) come from Richard Sheridan in the March issue of the newsletter The Budget $cene in Ohio (Federation for Community Planning, 614 Superior Ave., N.W., Cleveland, OH 44113). The Center for the Study of the States (411 State St., Albany, NY 12203) publishes quarterly summaries of state tax collections in State Revenue Reports. The February edition is the basis of the numbers in the article. In the table showing successive fiscal surveys, **Reports** subtracted $2.2 billion in FY 1991 and $2.4 billion in FY 1992 from the reports of the April 1991 survey to reflect approximately the amounts of federal aid that Illinois included in general fund totals in that survey but appears to have excluded from subsequent reports.

Cascading Fiscal Problems: The Indiana material is from the February Fiscal Policy Bulletin of the Indiana Fiscal Policy Institute (251 N. Illinois St., Indianapolis, IN 46204). The Wisconsin material is from the Wisconsin Taxpayers Alliance (335 W. Wilson St., Madison, WI 53703) newsletter, Your Wisconsin Government (3/13). The one-time measures finally adopted are larger than those described. **Reports** takes some liberty with local fund definitions to make fiscal information intelligible outside the state of origination.

State And Federal Fiscal Performance: The comparative deficits chart reflects quarterly results at seasonally adjusted annual rates, using national income accounts concepts, as presented in the Survey Of Current Business (March). Adding retirement funds would reduce the federal deficit, for example, by $36.7 billion in 1991 IV. A comparable adjustment would put the state and local sector in surplus by $40.4 billion. A state and local deficit is common because borrowing for capital outlays exceeds repayment on past bond issues. In **Reports**, fiscal years are designated FY and years without a prefix are calendar years.

Measuring State Finances: Gold's assessment appeared in "How Much Did State Taxes Really Go Up In 1991?" published by the Center for the Study of the States.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 10

IN THIS ISSUE

Many states are going to great lengths to get through November without major tax hikes or spending cuts, despite continuing revenue shortfalls and spending overruns. Tax cut proposals are alive, but not well.

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Recent riots, earthquakes, and droughts are just a sample of California problems identified by a "competitiveness" panel. The group is urging more pro-business policies.

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As the richest states falter, other states are raising per capita incomes closer to the national average.

- Changing Economic Fortunes p. 10

If state policies change with changes in voter profiles, policies must increasingly respond to those over 45.

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Tight finances are a drag on action in education. Signs of educational failings remain along with determination that state action will correct them. Measures comparing states remain tentative and controversial. The pace is slow in implementing education reforms and experimenting with school choice.

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May 1992 (Second Of Two May Issues)

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FISCAL POLICY UPDATE

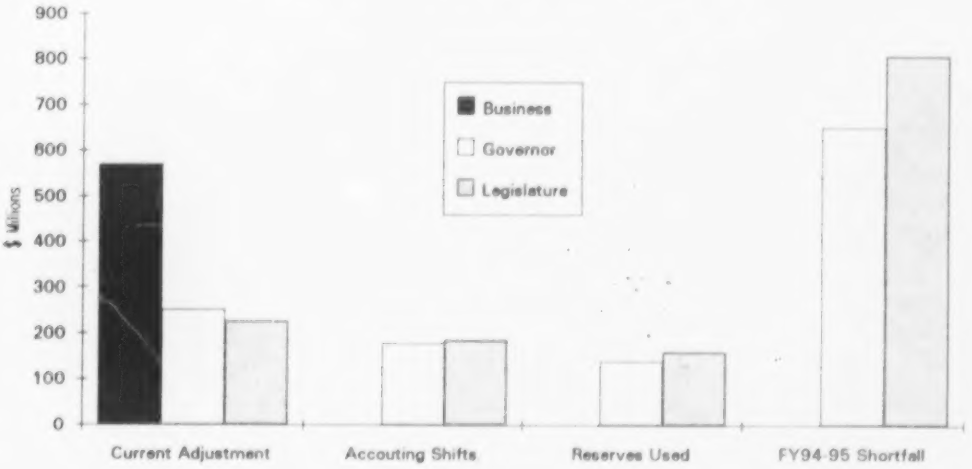
By normal standards, this would be a year for major state actions on taxes. A recent National Conference of State Legislatures report, NCSL State Budget Update: April 1992, concludes: (1) three-fifths of the states have FY 1992 revenues below estimates on which budgets were based, (2) revenue estimates for FY 1993 suggest growth "near or below the inflation rate," and (3) three-fifths of the states have FY 1992 spending overruns.

In other words, most of the returns are in on FY 1992 with widespread worse-than-predicted results. The outlook for FY 1993 isn't good either. **Sooner or later something has to give.** Spending patterns need to be cut sharply. Or taxes need to go up. Neither appears to be happening for reasons discussed in detail in Issue 9.

Deferring Problems, Minnesota Style

A good indication of what appears to be happening throughout the country comes from a summary of the already completed Minnesota legislative session developed by the Minnesota Business Partnership. **Reports** used it to create the chart below. Minnesota's case is particularly useful because the contending players seem to agree on numbers. This isn't common in debates on fiscal strategy, particularly those involving shifts to future years.

Dealing With Minnesota's
FY 1992-93 Shortfall



Minnesota enacted a budget for the FY 1992-1993 biennium in its 1991 legislative session. For the same reasons affecting other states, it developed a shortfall of $569 million in that budget, requiring action in the 1992 session.

The Partnership argued that the state should make adjustments to spending patterns to maintain a balanced budget without touching the planned year-end reserve of $400 million. A strict balanced budget posture would accept any combination of tax increases and spending cuts that reestablished balance on a current basis. As shown by the chart, the governor recommended that less than half the problem be handled by current adjustments. The legislature reduced this amount.

To avoid major changes in spending patterns or taxes, the governor and legislature agreed to use accounting changes and draw down reserves. One effect, shown in the final column, is that the current service deficit for the next biennium is over $800 million. It would have been zero if the adjustments had been made by permanent spending cuts and/or tax increases.

While taking these actions in the regular budget, Minnesota was committing large sums outside that budget. Its HealthRight plan will be financed primarily by $176 million of medical provider taxes plus $18 million each from increases in taxes on cigarettes and insurance premiums. Taxpayers won't see the taxes until after the elections. The major impacts of spending won't arise until the next biennium.

As was the case in other states, the final count of spending reductions included many items that would not be considered lower spending in standard definitions. The largest single item in the $187 million of spending adjustments was the repeal of sales tax exemptions for local governments. Another item was an $11 million reduction in health care which presumably reflects increased spending on HealthRight.

Tax Policies On Hold

> *As the state-by-state summary shows, moves to increase state revenues significantly are rare so far.*

This assessment in a new NCSL report on state finances reflects the strong aversion in state legislatures this year to changes in state tax systems. The prevailing view, so far, seems to be to avoid tax increases in the regular legislative sessions even at the price of pushing massive fiscal problems into lame duck sessions in December and regular sessions next year (see Issue 9). Sharp spending cutbacks are also being avoided.

Major tax restructuring is on the agenda now in only three states. Alabama is still working on a massive revision package. Nebraska and Texas are forced into considering tax revision by court decisions undermining their property tax systems.

Maryland has adopted a package of major increases and Florida officials are still fighting over one. But the other action is more like the Mississippi and Tennessee sales tax rate increases and debates over relatively minor measures in states like Ohio and Rhode Island. Elected officials in states under extreme fiscal pressure, such as California and Illinois, continue to renounce major tax increases.

A Painless Revenue Enhancement?

The giant exception to the apparent moratorium on tax increases is taxes on health care providers. These are sailing through many legislatures under what would have to be called "deep cover."

Proponents aren't calling them tax increases, which wouldn't avoid debate if the taxpayers adversely affected were challenging them.

But health care providers, particularly nursing homes and hospitals, are being promised significantly higher reimbursement rates and avoidance of cutbacks in Medicaid-eligible recipients and services if they support the increases. So they often aren't opposing them. Organized business and organized labor both fear paying more through 100% in-state payment of uncompensated care than from Medicaid funding cost-shared with the federal government. So they generally aren't opposing them either. Statehouse reporters are equipped to write day after day on disputed minor revenue increases, but not to cover major increases that don't generate disputes.

Bucking The Trend With Tax Cuts

The three major tax cut initiatives by state elected officials this year aren't going well.

In **Massachusetts**, tax revenues are outperforming expectations despite direful performance of the state's economy. But non-tax revenues, like asset sales and refinancings, aren't working out well. Nor are expectations for some of the planned spending cutbacks. Local finances, the source of many state savings, are showing increasing signs of strain. The governor is continuing his push for tax reduction.

In **Michigan**, the state's budget is in awful shape, but the governor (R) and legislative leaders (D&R) continue to push alternative plans to cut property tax burdens.

In **New Jersey**, the legislature's majority (R) has sent a one-cent reduction in the sales tax to the governor (D). The majority is large enough to override a veto and will probably do so if the governor makes it necessary.

The next move is financing the sales tax reduction in a budget probably not balanced even with revenues from the tax. An obvious target is a massive property tax rebate. Money from the 1990 tax increase was used to expand it to renters and to a maximum of $500 a household. Democrats, with help from senior citizens, are defending the rebate with brochures and radio ads, "They're after your money and they know where you live." Democratic legislators are wearing lapel pins asking, WHO GETS CUT?

In May, the state treasurer indicated that disappointing revenues have led to a shortfall of $342 million in a state budget of about $15 billion. Rolling the bad news forward indicates a similar shortfall in the governor's FY 1993 budget proposals which already presume that the sales tax will not be reduced.

The governor's proposals presume that the federal government will provide $380 million in extra income from retroactive Medicaid payments, with no corresponding increase in state spending. One source of apparently painless savings, reducing retirement contributions, is also already reflected in the budget submitted by the governor.

Voter-Forced Tax Cuts In Oregon

The winner among tax cutting efforts this year may be voter-initiated Measure 5 in Oregon. It requires reductions in property taxes and mandates the state to make up the loss in school revenues. The governor has held nationally publicized CONVERSATIONS WITH OREGON voters. But she found little interest in the obvious financing source, a sales tax, which voters have rejected eight times in the past 60 years. Anticipating disaster in the next biennium, the governor has announced she will cut state employment by 4,000 workers in the next 18 months.

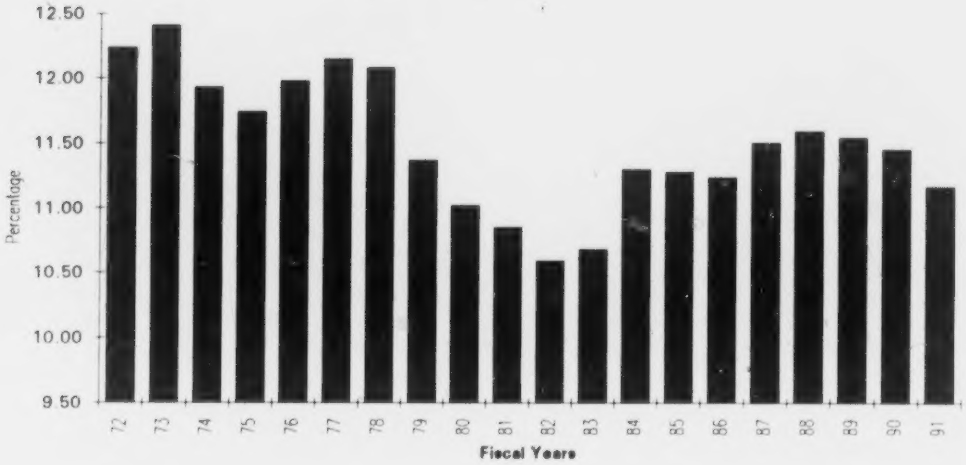
Despite her avoidance of tax increase proposals, the governor is under heavy fire from many different directions. In May, leaders of a movement to recall her under the state's direct democracy procedures presented petitions which they claimed would produce the necessary 167,000 valid signatures (15% of the vote for governor in the last election). The signature requirement apparently wasn't quite met, avoiding a recall election this summer.

Discontent comes from many unrelated directions -- abortion foes unhappy with her pro-choice stance, those interested in spending who object to spending cuts and her unwillingness to campaign for a sales tax, and timber interests who don't think she has stood tall enough for the industry against environmental challenges (like saving the spotted owl) that are curtailing logging.

Stable State and Local Tax Levels

Though arguments over changes in taxes and spending provide annual crises in state and local governments, when the shouting stops the nationwide results remain remarkably constant from year to year. The percentage of personal income taken by state and local taxes has stayed in a narrow band of 11-12% for the past two decades. The fluctuations above and below this range are emphasized by the chart. They result primarily from the impacts of business cycles on both personal income and the yields of state taxes, even when rates remain unchanged.

State And Local Tax Revenue
Percentage of Personal Income



The percentage of these taxes that are raised by state governments rose from about 55% in 1971 to just over 60% in the early 1980s. Since then, it has dropped to about 60%. Conflicting forces are at work. The state share has been increased by assumption of formerly local responsibilities for welfare, social services, health, and the courts and by the moves to increase the state share of education spending. But many states are now forcing cities and counties to take more responsibility for raising the money they spend and giving them access to sales and income taxes. Both actions have tended to increase the local share.

The net effect of state actions to deal with recession will likely further increase the local share. Many states have curtailed the growth in state school aid while cutting back on general local government aid. Recession typically takes its toll on the state sales and income tax base much more quickly than on the local property tax base, particularly in states where assessment changes lag property value changes.

CALIFORNIA WOES

> *We started out being worried, and we ended up with the conclusion that things were much worse than expected and much worse than you know. We're on the precipice and about to drop off.*

This was just one of the depressing comments by Peter Ueberroth (successful businessman, former baseball commissioner, and manager of the Los Angeles 1984 summer Olympics) as he presented the report of his Council on California Competitiveness at a press conference in April. Just about every aspect of California's public policy picture has been coming up ugly lately.

The Economy And State Policy

Through much of the 1980s, California's economy so consistently outperformed national averages that revenue estimates were based upon what amounted to adding a percentage point to projected national growth rates. **California's superior performance has ground to a halt.** Unemployment in March was 8.7%, well above the national average. Other indicators of economic performance have dropped below national averages.

No one knows how much state action and inaction has contributed to the problem. **Business leaders and Governor Wilson believe state government's impact has been substantial and negative.** Wilson, who joined the press conference on the competitiveness report, commented, "Over the period of a couple of decades, we have imposed, cumulatively, a job-killing burden on the ability of California employers to compete." Critics contend the state compares unfavorably with competitors, particularly for manufacturing jobs, in such factors as business taxes generally, Workers' Compensation taxes and policies, tort liability, environmental regulation substance and processes for resolving issues, and government-influenced costs of housing and health care. Observers inside California and out view the state as mobilizing much less well than other states for interstate development competitions such as those for the supercollider project.

The Physical Environment

California's environment has been its developmental long suit with assets ranging from climate and excellent ports to fine locations for high value agriculture. But, **rapid population growth has magnified the constraints of the environment.** The constraint of limited water in Southern California was overcome by extensive investments in dams and aqueducts. Demand has now outrun supply, with the recent drought highlighting the problem, not causing it. The many proposals over several decades to bring more water from the North have been stalled in controversy. Whether done by rationing and allocation mechanisms or by market pricing, the result is likely to be less water for agricultural uses.

The airflows in metropolitan areas, particularly around Los Angeles, don't easily dispose of air pollution. As a result, California already has stiffer (and more expensive) standards for industry and vehicles than other states. There are widely publicized proposals for further restrictions that would increase the costs of doing business as well as cramp lifestyles (e.g., fireplaces and barbecues).

Demographics And Migration

Demographic factors are extremely unfavorable for California's finances. The primary culprit has been migration, both legal and illegal. It quickly translates into social welfare costs (though there is substantial dispute over whether the economic contributions of migrants outweigh these costs) and into education costs associated with burgeoning enrollments. The Ueberroth report assesses the situation by starting with an annual population gain of 600,000 people a year, requiring an increase of about 250,000 jobs a year to provide the revenues to cover the added cost. It is difficult to imagine how the state's economy would grow at that pace, particularly given the loss of an estimated 340,000 jobs in the past year.

State Finances

While there is dispute among experts over whether all states face them, there is little question but that **California has a large, persistent structural budget deficit**. Besides unfavorable demographics, its laws simultaneously curtail revenue growth (e.g., indexing the state income tax for inflation, Proposition 13 limits for local taxes) and mandate spending growth (e.g., Proposition 98 guarantees of state education spending, indexing payments under many programs for inflation). Governor Deukmejian was fond of saying that if California finances were left on autopilot, spending would grow 11% a year while revenues grew 7% a year.

Last year's tax increases and spending restraints clearly didn't solve the problem. The governor's budget announced a new deficit. Since it was issued, all concerned agree that it understated the size of the problem. Ueberroth characterized the problem as "an exploding shortfall" and predicted "California will run out of money in a dramatic way right around the corner." On a budget accounting basis, current estimates of the end-FY 1992 deficit range from $4 billion to $7 billion, as much as 10% of the budget. The controller is warning that a "sea change" in state finances means the state will also have a cash flow problem as early as June.

Legislative consideration of budget issues has bogged down. Majority Democrats in the legislature are trying to blame the Republican governor. The governor is appealing over the heads of the legislature to the electorate. The outcome is in doubt. The effect of the process isn't. The impression is not one of officials in control of the situation disputing details of how to handle it, but one of officials not in control of the situation.

The Political Process

The California political process, as distinct from the resulting policies, is a cause of adverse business perceptions. Heavy use of the initiative means that policies clearly less favorable to business than the legislature itself would likely adopt are constantly a possibility.

The process can also lead to concerns that state government overall (including the voters legislating by initiative) is inept. While **Reports** knows of no empirical basis to support such a conclusion relative to other states, anecdotally it isn't hard to find problems. For example, all of the state's insurance reforms have gone awry. Solvency regulation hasn't prevented company insolvency. The promise of lower rates from Proposition 103 has not been realized. Legislation to provide earthquake insurance coverage has so many problems the insurance commissioner has recommended that the whole program be scratched.

Education

The competitiveness panel was highly critical of California's public schools: "Our schools have become one of history's great social experiments -- and the experiment is not a success." The Sacramento Bee (4/27) succinctly summarized the criticisms:

> *Too many kids can't read. Too many drop out. Nobody accepts the blame. Taxpayers aren't getting their money's worth. Businesses can't find well-trained applicants.*

In public schools, California has opted for the second largest class sizes in the nation and the fourth highest teacher salaries. This unique combination permits state per-pupil spending below the national average. The higher education system has long been known for its accessibility, with a comprehensive community college and university system available at comparatively low costs to students. Enrollment pressures have made courses harder to get and fiscal pressures have caused sharp tuition increases at all levels.

The Proposed Solutions

The Ueberroth report recommendations read much like business community recommendations for governmental change in other states. Its major features are (1) tax breaks for business including lower capital gains taxes and tax incentives for job creation, (2) Workers' Compensation reform, (3) tort law reform, (4) more expeditious handling of environmental and land use permits, (5) improvements in the schools, including lengthening the school day and school year and an education choice plan.

CHANGING ECONOMIC FORTUNES

Per Capita Income

Newly released data show that, despite recent economic problems, Northeastern states continued to lead the nation in per capita personal income in 1991. They reflect the concentration of economic growth through much of the 1980s on the seacoasts, the "Bicoastal Economy." Among the top 13 states, only Illinois (#10) doesn't border an ocean. Southeastern states lag, as they have since the Civil War. However, Idaho, New Mexico, Utah, and West Virginia are also in the bottom ten.

Per Capita Personal Income, 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$25,881		**United States**	**$19,082**	34	North Carolina	$16,642
2	New Jersey	25,372	18	Florida	18,880	35	Arizona	16,401
3	Massachusetts	22,897	19	Rhode Island	18,840	36	South Dakota	16,392
4	New York	22,456	20	Michigan	18,679	37	Tennessee	16,325
5	Maryland	22,080	21	Kansas	18,511	38	North Dakota	16,088
6	Alaska	21,932	22	Wisconsin	18,046	39	Montana	16,043
7	Hawaii	21,306	23	Ohio	17,916	40	Oklahoma	15,827
8	California	20,952	24	Nebraska	17,852	41	Alabama	15,567
9	New Hampshire	20,951	25	Missouri	17,842	42	Kentucky	15,539
10	Illinois	20,824	26	Vermont	17,747	43	South Carolina	15,420
11	Delaware	20,349	27	Oregon	17,592	44	Idaho	15,401
12	Virginia	19,976	28	Iowa	17,505	45	Louisiana	15,143
13	Washington	19,442	29	Georgia	17,364	46	New Mexico	14,844
14	Colorado	19,440	30	Maine	17,306	47	Arkansas	14,753
15	Nevada	19,175	31	Texas	17,305	48	Utah	14,529
16	Pennsylvania	19,128	32	Indiana	17,217	49	West Virginia	14,174
17	Minnesota	19,107	33	Wyoming	17,118	50	Mississippi	13,343

The disparities among residents of different states in purchasing power is somewhat less than the disparities in per capita personal income. Federal income and Social Security (FICA) taxes take larger bites out of personal income in the more affluent states than in the poorer ones. Per capita state and local taxes are also generally higher in the affluent states. A case can be made that prices are also higher in affluent states, though consistent and reliable data comparing price levels haven't been available since the federal government stopped collecting such statistics a decade ago.

With a common currency and free movement of goods, capital, and labor, one would expect disparities among states to level out over time. This concept, *the convergence hypothesis*, is amply supported by what has happened in the United States from decade to decade, but not by changes during much of the 1980s.

Per Capita Income Changes

Convergence has reappeared as shown by the recent changes in per capita income in the table below. Its low-ranked states reflect the puncturing of economic development bubbles in Arizona, California, Nevada, and New England, as well as slower growth in formerly rapid growing Florida, Georgia, Maryland, and Virginia. The leaders in recent growth include many of the low per-capita-income states such as the Dakotas, Louisiana, and West Virginia.

Percentage Increase In Per Capita Personal Income, 1988-1991 and 1990-1991

Rank	State	88-91	90-91	Rank	State	88-91	90-91	Rank	State	88-91	90-91
1	North Dakota	28.8%	4.8%	18	Oregon	17.3%	2.4%	34	New Jersey	14.3%	2.0%
2	South Dakota	27.0	3.2	19	Nebraska	17.1	2.1	35	Missouri	14.2	2.1
3	Hawaii	25.2	4.6	20	New Mexico	16.9	4.1	36	Maine	13.8	0.7
4	Montana	24.0	4.8	21	South Carolina	16.6	1.8	37	Vermont	13.5	1.4
5	Wyoming	21.5	5.1	22	Colorado	16.6	3.1	38	Florida	13.4	1.8
6	Louisiana	20.1	4.2	23	Oklahoma	16.6	2.4	39	Delaware	13.4	1.3
7	Kentucky	19.4	3.6	24	Pennsylvania	16.5	2.4	40	Maryland	13.2	1.0
8	Idaho	18.9	1.0	25	Wisconsin	16.4	2.6	41	Michigan	13.1	1.6
9	Utah	18.9	3.9	26	Illinois	15.9	1.9	42	Virginia	13.0	1.4
10	Alabama	18.4	3.8	27	Kansas	15.7	2.2	43	Georgia	12.9	1.9
11	West Virginia	18.4	3.1	28	Minnesota	15.7	2.0	44	Connecticut	12.7	1.9
12	Arkansas	18.3	4.1	29	New York	15.7	1.5	45	California	12.1	1.3
13	Washington	18.2	3.5	30	North Carolina	15.7	2.3	46	Nevada	11.6	0.7
14	Mississippi	17.9	4.0	31	Tennessee	15.6	2.9	47	Rhode Island	11.3	0.2
15	Iowa	17.7	1.2		**United States**	**15.0**	**2.1**	48	Massachusetts	11.1	1.5
16	Alaska	17.7	1.3	32	Indiana	14.9	1.7	49	Arizona	11.0	2.5
17	Texas	17.5	3.5	33	Ohio	14.6	2.0	50	New Hampshire	7.8	0.9

From 1988 to 1991, top-ranked Connecticut's advantage over the national average fell from 38% to 36%, second-ranked New Jersey's from 34% to 33%, and Massachusetts dropped from a 24% lead to a 20% lead. Lower ranked states were closing from the bottom. As a group, the bottom ten states moved from 75.6% of the national average in 1988 to 77.9% in 1991. Every state in this group moved closer to matching the national mark. In the past year, per capita income in the bottom ten states rose 3.4% while the increase was just under 2% for the average state in the top ten.

The one-year changes are generally consistent with the three-year changes, with the worst performances in New England and Nevada. The bad news in the one year changes is that national growth (and growth in 43 states) was below the 4.1% inflation of the past year. Put another way, purchasing power declined in 1991, the first year it has done so since 1982, which was also a recession year.

Food Stamp Participation: Participation in the Food Stamp program highlights the differing performance of state economies even more than changes in per capita income. About 25 million Americans used Food Stamps in January, nearly one out of every ten. As would be expected, participation rates (States In Profile, Table H-10) are highest in the states with the lowest per capita incomes. However, there are dramatic differences in the changes in the number of recipients. The table shows the states with the largest and smallest changes.

Percentage Increase In Number of Food Stamp Recipients, January of 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Florida	46.2%	8	Indiana	21.6%	44	Kentucky	7.8%
2	Nevada	31.1	9	Alaska	20.3	45	Illinois	7.4
3	New Hampshire	29.6	10	Arizona	20.0	46	Arkansas	7.2
4	Delaware	27.1		**United States**	**14.0**	47	South Dakota	6.2
5	Virginia	25.7	41	Hawaii	8.9	48	Mississippi	4.3
6	New Jersey	23.6	42	Iowa	8.9	49	Louisiana	3.3
7	Connecticut	21.8	43	Nebraska	8.1	50	Michigan	1.4

The states with the most dramatic increases are those with high per capita incomes, often states that were economic success stories of the 1980s. The smallest increases are found in lowest per capita income states, including bottom-ranked Mississippi, and in states that faced 1980's crises in the auto industry (Michigan) and agriculture (Iowa and Nebraska).

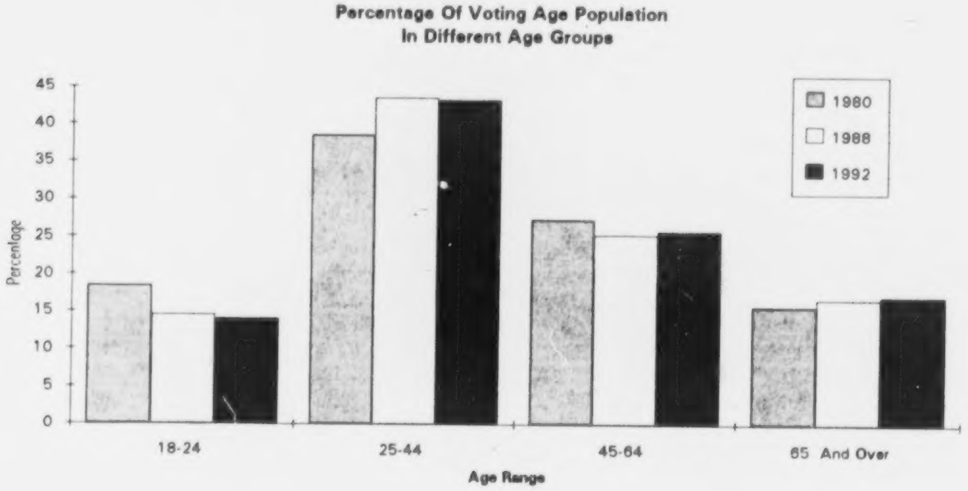
WHO VOTES

In advocating [insert policy position], [insert candidate name] *is keeping his eye on where the votes are.*

This is a kind of generic quote about candidates' positions on issues that journalists use routinely, as CBS News did (5/9), to reflect the widely accepted theory that elected officials keep an eye on who votes when adopting policies. What does that eye see? In most states, a rapidly aging electorate.

The Census Bureau recently estimated that about 189 million Americans will be of voting age this November. Ten million can't vote because they aren't U.S. citizens. Many more won't vote even though qualified to do so. About a third of the voting age population cast ballots for Members of Congress in the 1990 elections while only half voted for President in 1988, down from 53% in 1988 and from over 60% in the 1960s.

The rapid aging of the voting age population is shown by the chart. In November, 42.8% of potential voters will be 45 or older, a percentage that will climb rapidly as more post-World War II baby boom children pass age 45.



The age profile of the electorate varies considerably by state. The table below shows the percentages of potential women voters in selected large states. Utah and West Virginia are included to illustrate the extremes. Almost half of the female voting age population is over 45 in West Virginia versus under 40% in Utah.

Percentage Of Female Voting Population By Age, 1992

State	18-24	25-44	45-64	65 And Over
US	13.0%	41.8%	25.6%	19.7%
California	13.5	45.0	24.6	16.9
Florida	10.7	36.7	26.3	26.3
Illinois	12.9	41.9	25.5	19.8
Massachusetts	13.0	41.5	24.5	21.0
Michigan	13.5	42.0	25.6	18.9
New York	12.4	41.1	26.3	20.1
Pennsylvania	12.1	38.5	26.0	23.5
Texas	14.4	44.0	24.9	16.7
Utah	18.4	43.3	22.9	15.4
West Virginia	12.4	37.5	27.0	23.1

The impact of older people on elections is greater than their share of the voting age population. Turnout increases with age, as well as with income. In the 1990 elections, about 45% of those over 50 voted while the turnout for all age groups was only 36%.

Differing age and income profiles explain much, but not all, of the differences among states in voting. In 1988, over 60% of the voting age population cast a Presidential ballot in the Dakotas, Maine, Minnesota, Montana, Utah, and Wisconsin. With turnout below 45%, compared with a national average of 50.1%, the low voter participation states in 1988 were the Carolinas, Florida, Georgia, Hawaii, Nevada, and Tennessee.

There is no state issue that has the same obvious salience for older voters as Social Security is perceived as having in national elections. However, the increasing number of older voters is widely believed to increase resistance to local property taxes. These voters don't have children in school and are most likely to experience property taxes disproportionate to their current income.

EDUCATION REFORMS LAGGING

National Education Progress Limited, Hard To Measure

> *The American people believe strongly in the power of education. The best available data, however, show our performance falls short of the standards we need to meet to compete effectively in the global economy.*
>
> *We've got to transform the way our schools are organized and what they're doing, what they're teaching, how teachers are trained, what schools look like, and how they're staffed.*

These were the comments of Governor Romer and U. S. Education Secretary Alexander on the release of the first report detailing how the Bush Administration and the governors were doing in reaching the six education goals they established a year earlier. The substance of the report was captured by headlines at the time: "Education Goals Called Far From Realization," Washington Post (10/1/91) and "Data, Strategy Said Missing In Report On Goals, But Educators Hail Effort As First Step," Education Week (10/9/91). The heavy emphasis on quantified measures of student achievement was lauded by the usual advocates and criticized by the usual critics. Like other measures, they tended to show the U.S. lagging in relation to other nations and showed substantial differences among states.

Education Reform In The Legislatures

Much of the energy focused on school reform in the last few years has shifted to school funding.

This isn't the year for large-scale education reform measures combining management reforms, large spending increases, and higher taxes -- like the ones most recently passed in Kentucky and Oklahoma. The quote above -- from the Jackson Clarion-Ledger's look at the Mississippi situation this spring (3/1) -- suggests why.

The exception is **Alabama** where education reform and tax reform are linked in one 33-bill package. Among other things, the bills alter teacher tenure, offer principals a $5,000 salary hike to give up their tenure, and limit the revenue that can be assumed in enacting a state budget to prevent downward mid-year adjustments (pro-rations) that have plagued Alabama school administrators in recent years. A proposal to end election of school superintendents was defeated. The package has passed in the House and is now in the Senate. Once passed, it needs approval by the governor for bills and by the voters in November for the many constitutional amendments required.

In calling a special session for early this year to deal with the linked proposals for education reform and a new income tax, Governor McWherter said the choices were clear, "You're either for the kids, you're for education, or you're against. It's time to put up or shut up." Legislators did a little of each. The **Tennessee** enactment is a scaled down version of earlier education reform proposals, corresponding to the scaling down of the revenue portion from a new income tax to a sales tax hike. The legislation phases out electing local superintendents, increases school finance equalization, and adopts an annual state "report card" on school performance. School-based management is emphasized to the point that the governor boasts, "No state in America will give its schools the amount of local control contained in this bill."

The clearest victory for education funding in 1992 is better understood as regaining lost ground in state education funding than capturing new ground for education reform. In 1990, **Mississippi** officials separated education funding (including inflation-related pay gains for teachers) from the rest of the budget to link BEST (Better Education For Success Tomorrow) with tax increases. For complex reasons, the tax increases never passed, so the reform package never went into effect. Responding to lower-than-expected revenues, school aid was cut last June and cut further this February. Higher education tuition jumped 16% last fall. The sales tax increase recently passed over the governor's veto was designed to salvage basic school funding, not to revive many of the BEST reforms. Without it, the legislature would presumably have adopted the funding freeze for higher education and the 1% public school increase recommended by the Legislative Budget Committee.

Ohio is more typical of what is happening in most states. The immediate concern is funding. Schools lost $78 million in mid-year budget adjustments this year. For FY 1993, the governor is seeking higher alcoholic beverage and cigarette taxes and other revenues to avoid further cuts. School finance and education quality proposals are being studied by a blue ribbon group. The objective is consideration of legislation on these subjects in 1993. The blue ribbon group in **Rhode Island** reported this spring, with recommendations for: (1) legislative reaffirmation of the oft-stated goal of 60% state funding of education costs, (2) school finance equalization, and (3) many measures to improve school performance. Prospects for enactment of the proposals this year, when the governor's budget proposes tax hikes and freezing school aid, are understandably not good.

The worst case examples are those states where the retreat from prior education reform measures has been clear and explicit. In **Maine**, the governor's campaign for lengthening the school year by five days turned into 1991 legislation that permitted school administrators to shorten the school year by up to five days to deal with state aid cutbacks. The mandatory class size maximum for kindergartens was loosened for the same reason. The state-funded statewide educational assessment test for all students in grades 4, 8, and 11 is being dropped.

New Reform Ideas Discount Legislative Roles

Money isn't the only cause for declining interest in major education reform packages in the legislatures. Legislators and governors have already invested considerable political capital and taxpayer money in long lists of reform measures adopted in the 1980s. They have many ways to assess the results, all indicating they were not dramatic. Anecdotally, there are the cross-generation comparisons that are the stuff of family gatherings. There we form impressions of whether new generations of students get better schooling and know more than we. Stronger anecdotal evidence comes from the continuing testimony of business leaders about the products sent to them by the schools. For those more quantitatively inclined, there is the stubborn resistance of test scores, like SAT scores, to increase over time and frequent assessments that the U.S. system is producing less well educated workers than those of other nations.

More sophisticated research into the results of education reform doesn't change the picture. For example, one recent assessment by a consortium of high caliber universities produced this conclusion:

> *The decade was notable for the breadth and the persistence of the movement for educational reform centered at the state and local levels. Moreover, recent test scores provide only limited and selective evidence of any increase in student learning.*

At a time when there is some disappointment with recent reforms and discussion of changes as diverse as national standards, choice, and restructuring, it is important to reflect on recent developments and their implication for the future.

Heavy costs, controversial changes, uncertain progress, and a call from evaluators "to reflect" are not the stuff out of which legislative action is made. The competition for legislative attention and state money, in education and other fields, comes from many programs that offer low costs, changes without enemies, immediate and measurable results, and beliefs held by ordinary citizens and professional evaluators that the action does some good.

Another major factor discouraging legislative interest in school reform is the increasingly widespread opinion that top-down solutions, as contrasted with school-based solutions, are ineffective.

Recent events in Massachusetts are indicative of the problem. The state, with a strong tradition of local autonomy and somewhat more confidence in educational results than the in the Southeastern states that pioneered in the state reform measures, has never bought into the complete education reform agenda of the 1980s. Meanwhile, it has crimped the resources of local officials by a combination of centuries-old restrictions preventing them from using sales and income taxes, decade-old Proposition 2 1/2 limits on property taxes, and recent cutbacks in state funding of local governments, shifting much of the state's fiscal crisis to a local fiscal crisis.

In this environment, the governor (R) and legislative leaders (D) have agreed on the outlines of education reform and on a future state financial commitment. Two elements of reform are of particular interest: (1) more money for schools for traditional purposes such as teacher salaries and materials for students and (2) some version of educational choice. The question is what else the plan should include. Into this setting, the reasonably influential Pioneer Institute dropped a major 304-page report, Reinventing The Schools.

Like other recent thinking in education, the report is *not* suited for review by legislators and staff members looking for bills to pass to improve education. It's tone is to discourage, not encourage, legislative action. The press release says, "The report reviews the well-intentioned but failed interventions of the last two decades and urges that the legislature, the courts, the unions, and district administration agree to free up the schools and restore the discretion and authority of school staff to devise successful solutions." A key passage in the report concludes, "Good schools cannot be legislated."

COMPARING STATES' EDUCATIONAL ACHIEVEMENTS

Some progress is being made toward the objective of making available quantitative comparisons of state achievements in education. The obstacles remain disagreement over what measures are appropriate and refusal of some states to participate in the use of whatever measures are available, despite inadequacies.

The table provides state rankings based on several education indicators. The three measures are: (1) the percentage of adults who have finished high school, (2) Scholastic Aptitude Test scores adjusted for the percentage of students taking the test, and (3) scores on a new test of math proficiency taken by eighth grade students (see Technical Notes for details).

State Rankings In Educational Achievement
Percent H.S. Graduates, Scholastic Aptitude Test (adj.), and Math Proficiency

Rank	State	Grads	SAT	Math	Rank	State	Grads	SAT	Math
1	Iowa	9	2	2	26	Pennsylvania	33	30	12
2	Minnesota	5	6	4	27	Missouri*	35	19	
3	North Dakota	16	3	1	28	Virginia	38	25	13
4	Kansas*	13	4		29	Arizona*	22	34	
5	Montana*	8	7		30	Hawaii	11	35	27
6	Washington*	2	16		31	California	24	31	23
7	New Hampshire	12	1	9	32	Indiana	26	42	15
8	Oregon	7	9	8	33	Maine*	32	29	
9	Nebraska	14	14	3	34	Ohio	28	33	20
10	Wisconsin	17	11	5	35	Tennessee*	48	13	
11	Alaska*	3	21		36	Michigan	31	39	17
12	Connecticut	21	8	6	37	Rhode Island	40	26	21
13	Colorado	10	12	14	38	New Mexico	37	23	29
14	Massachusetts*	20	10		39	Florida	27	40	26
15	Vermont*	15	18		40	Oklahoma	36	36	24
16	New Jersey	23	17	7	41	Kentucky	49	28	28
17	Wyoming	4	32	10	42	Georgia	42	46	22
18	Illinois*	30	5		43	Texas	39	45	25
19	Maryland	18	15	16	44	Louisiana	43	37	34
20	Utah*	1	38		45	North Carolina	41	48	32
21	Delaware	19	22	19	46	West Virginia	45	47	30
22	Idaho	29	24	11	47	Arkansas	47	44	31
23	Nevada*	6	41		48	South Carolina*	44	49	
24	South Dakota*	25	27		49	Alabama	50	43	33
25	New York	34	20	18	50	Mississippi*	46	50	

The overall rankings are based on an average of the other rankings shown. They are based on two, rather than three, ranks for designated states (*) because education officials of those states have successfully continued to resist comparative numbers. As is easily seen, the state ranks on one measure are closely correlated with state ranks on the others, with a few exceptions. For example, California is about average in all three measures. Southeastern states are consistently low on all three. Iowa and Minnesota are in the top ten in all three.

Many people don't like numbers like these. They clearly don't indicate how good a job public schools are doing with the material sent to them by families. But **Reports** considers them a decent indicator for some purposes. For example, the chances that a higher percentage of high school students and adults chosen at random from Iowa or Minnesota could understand this article are considerably greater than a comparable group of Alabama or Mississippi residents. The state rankings are similar to those found on the Armed Forces Qualification tests -- uniform tests given to new military personnel.

CHOICE EXPERIMENTS LAGGING

Choice As A Quiet Issue

Concerns that the best efforts to reform education from the top down aren't working, combined with preferences for private suppliers, have generated considerable interest in educational choice plans. **The logic of choice supporters is that the best discipline for the public schools will come from competition with private schools.**

If state officials bought this logic, they would provide per-student subsidies for private schools approximating the costs they avoid from not funding the same students in the public schools. However, this policy would be extremely expensive because it would pay for both: (1) students diverted from public schools and (2) a much larger group of students who would attend private schools without the subsidy. As a result, the choice proposals usually reflect the presumed savings from the diverted students spread over all the private enrollment. This, and proponents' guesses of what might be feasible to enact, lead to per student subsidy numbers like the $900 in Pennsylvania's legislation.

Education and voter turnout statistics consistently show states like Minnesota, Montana, and North Dakota highest and Southern states lowest. The strongest statistical explanation has nothing to do with school spending or educational quality measures. It is ***latitude***, the farther North the better. This conclusion is a reminder of how little is known about what determines education success. Senator Moynihan repackaged latitude as the distance of state capitols from the Canadian border and displayed the impressive statistical results in an article reprinted in State Legislatures (April).

Choice plans that provide state support to students opting for private schools have provoked massive debate in education circles, but much less debate in the legislatures. There, and in recommendations of state blue ribbon task forces, **most of the action has centered on student choices confined to public education, among schools within a district and sometimes among districts.**

Choice And The Law

Powerful and well-financed interests will litigate every aspect of choice issues, which raise important questions including separation of church and state, desegregation, the education of the nation's children, and the jobs and pay of millions of school employees. The underlying issues affect other public services which involve equally large interests, including higher education and the immense industry of providing state-funded services like day care, home health care, and nursing homes. Therefore, **all statements about the law affecting choice (including those below) are controversial and subject to litigation.**

Under a purchasing rationale, states can clearly buy services in open markets regardless of religious and other characteristics of the sellers. So rugs in state office buildings can be purchased from monks, the Salvation Army, the Mafia, and wholly owned subsidiaries of the Nazi party or Black Muslims with impunity by purchasing systems that consider only the rug and not the supplier. This doctrine extends to purchase of slots in day care systems, bed-days of nursing home care, and student-years of higher education, if the purchase is clearly of the service, rather than any kind of subsidy to the supplier.

Under a tax rationale, states can subsidize through deductions and credits activities that they could not subsidize directly. One such purpose is the furthering of religious teachings and the operation of churches and synagogues. So donations to religious groups are deductible in most income tax systems and property used for both religious and secular purposes, including religious schools, can be exempted while other property is taxed. This is the rationale behind the Minnesota tuition deduction plan that was upheld by the U.S. Supreme Court in 1983. The latest litigation has been over Iowa's 1987 copy of that plan which provides a deduction of up to $1,000 per child for expenses of private school tuition and books. A federal district court sustained the plan in March, with appeals likely.

States may not subsidize religion. States may not discriminate on the basis of race and a host of other criteria. Most of the potential choice litigation arises because one of these national principles is said to conflict with the tax and purchasing rationales. Language in state constitutions on education (e.g., free public schools) and on rights of citizens provide an independent basis for litigation in individual states. The willingness of some state courts to interpret language in state constitutions differently from the U.S. Supreme Court's interpretation of identical or substantially similar language in the federal constitution also provides a fertile basis for litigation.

Choice Survives Wisconsin Court Review

The country has been watching Wisconsin for a signal. Now they've got it.

This was Governor Thompson's reaction to the recent state supreme court decision approving Wisconsin's voucher experiment. It provides state aid of $2,500 for each of about 550 inner city youth now attending private schools in Milwaukee. It is touted by choice proponents because it might presage an alliance between inner-city parents seeking better education and state officials, who find the price right, against public school administrators and teachers. It is one of the few examples of choice programs in operation that permit private schools as an option.

The main issue in the case wasn't the validity of choice but the method of enactment. A lower Wisconsin court had held the measure invalid because it was passed as part of the state's appropriations legislation. The applicable doctrine is that "private or local interest" legislation must be passed separately. The legislature complied with this provision by defining a class of cities that included only Milwaukee. Although treated by the national media as a legal victory for the choice concept, the majority in the 4-3 decision stated in its opinion "we pass no judgment on the wisdom or desirability" of the plan. However, the opinion ran for 40 pages, lauding the plan as proof that it wasn't special interest legislation.

Because the decision interprets the state constitution, there is no grounds for appeal to the U.S. Supreme Court. Collateral attacks in federal courts on other grounds are possible. The litigants, teachers and school administrators, have much at stake.

Choice Measures In Pennsylvania

> *Despite the bill's initial defeat, observers say, the Pennsylvania experience is illustrative of the bitter battles that may lie ahead for many states as advocates push school choice to new fronts.*

This Education Week (1/8) assessment was one of many suggesting the December choice debate in the Pennsylvania legislature was different than choice debates elsewhere. The Philadelphia Inquirer (12/12) and the New York Times (12/13) both used the phrase "intense lobbying" to describe the action.

The debate drew intensive involvement from Catholic leaders, who have been restrained in their support in other states. As in other states, public educators perceived the measure as threatening their livelihood and responded with vigor proportionate to this assessment. The measure to provide support of students in private schools passed the Senate by a narrow margin. It was rejected in the House by a vote of 114 to 89 with sizable numbers of Republicans and Democrats on each side. The issue is likely to reappear.

More Debates On Choice Likely

Choice issues are being debated in many states, with targets of the November election in California and the 1993 legislative sessions in other states. Legislation cleared a committee vote in the Illinois legislature to provide Chicago children scholarships of over $2,000 each to attend private schools. Given the state's fiscal circumstances, the measure's consideration this year is probably more of a protest against perceived high costs and low quality in Chicago public schools than a proposal likely to be enacted.

Supporters of the California initiative claim they have enough signatures to make the November ballot. It would provide vouchers of $2,500 a year that could be used to pay private school tuition. Current private school students wouldn't become eligible until 1995, two years after other students. Proponents have already spent over half a million dollars on their campaign, while opponents have expended about $200,000 to fight it by such methods as dispatching "truth squads" to sites where proponents were seeking signatures.

Arizona has a new blue-ribbon committee report on improving schools. It endorses choice, but not for private alternatives to public schools. Presaging next year's debate, the report is being criticized as recommending too much and recommending too little.

MISCELLANY

Ranking Legislators

Legislators are ranked casually with comments from lobbyists, reporters, and other legislators like, "so-and-so is the worst legislator I have ever encountered" or "one of the best freshmen members." A fancier, but no more valid, ranking occurs when small percentages of a group of observers, such as national reporters covering Congress, make such observations. Precise rankings are commonly issued by interest groups based on verifiable actions, such as how Members voted on issues. These rankings don't purport to measure effectiveness of legislators, just whether they supported the right side.

Most attempt at reputational rankings of state legislators don't deserve much credibility because of three problems: (1) no precise definition of who is being polled, (2) a low response rate among those polled because legislators and lobbyists don't want to risk getting caught making statements suggesting people they work with are ineffective, or (3) definitions of effectiveness that equate effectiveness with helping to enact an interest group's agenda. Over the years, **Reports** has seen many of these, such as a recent one in California, that fail one or another of these texts. The exception is the rankings that have been done since 1978 by the North Carolina Center. This year's version drew an 82% response from legislators themselves.

The results confirm the adage, "where you stand depends on where you sit." In the 1989-1990 session, House Republicans and some Democrats selected a new speaker. He got the second highest ranking, but the top ranking went to a co-chair of the appropriations committee. In the current session, Democrats hung together to elect the speaker. His star rose to first from sixth, the fiscal chair dropped to second, fellow Blacks rose with the speaker, and the top Republican fell from fourth to 14th. Turnover in the legislature will be higher than usual, but the reasons appear to be redistricting and quests for higher offices rather than disillusionment with legislative service found in some other states.

Virginia Follow-Up

Issue 8 featured concessions states are making to lure development and a discussion, featuring Maine and Virginia, about how frustrating the 1992 legislative sessions have been. Subsequent developments in Virginia confirm both themes. In its mid-April veto session, supporters of a transportation bond issue with a two-cent gas tax went for all or nothing rather than accept the governor's changes that would have put a smaller bond issue and no tax increase on the ballot. They got nothing. The governor supported legislation, that passed easily, to ban credit card late fees. In April he announced he was vetoing the provision. Household International announced simultaneously that it was beginning work on a Virginia facility for credit-card processing. The governor said his decision "demonstrates Virginia's willingness and ability to provide a good business environment for banks and other financial institutions while still protecting the rights of consumers." A consumer group said the decision would cost Virginians $33 million a year.

Welfare Reform Update

> *The Wisconsin plan replaces some of the old assumptions of the welfare state and recognizes the importance of personal responsibility, self-respect, independence and self-sufficiency... We must balance America's generous heart with our responsibility to the taxpayers.*

These were the President's comments on his recent approval of Wisconsin's welfare reform plan. He didn't endorse the plan but, as he has done before, lauded "innovation by the states" and supported flexibility in the federal outlook on waivers of federal rules requested by the states (see Issues 3 & 5 for examples and analysis). Wisconsin's plan has elements allowing recipients to keep more of the money they earn as well as its well-publicized cut in the benefit increase awarded when a welfare recipient has another child.

A new study of California's GAIN program shows that the effort to move welfare recipients to employment was successful, in the sense that participants improved their earnings more than members of a control group. However, the savings in welfare payments weren't dramatic. GAIN was one of the state precursors of the programs now required in all states by the federal welfare reform legislation passed in 1988.

TECHNICAL NOTES

Fiscal Policy: NCSL's report is State And Local Tax Levels: Fiscal Year 1991. In this annual report, NCSL provides rankings of state and local tax burdens that are a year more recent than those from the Census Bureau. To do this, NCSL assumes that local taxes in each state were the same percentage of personal income in FY 1991 as in FY 1990. The rankings of states by taxes in relation to income tend to be stable, particularly in years, like FY 1991, affected by few changes in state taxes. This stability is exaggerated by assuming that the local tax levels, 40% of the total, are constant. So users will get about the same result whether using FY 1990 numbers or FY 1991 numbers. The state comparisons are reprinted in other NCSL publications, State Legislatures (March) and The Fiscal Letter (March/April).

California's Woes: The Sacramento Center of the University of Southern California's School of Public Administration (1201 J St., Sacramento, CA 95814) publishes an annual book, California Policy Choices, with many insights into California's problems and policy choices. The 1991 edition includes chapters on state finances, the political process, school finance, health care, agriculture, earthquake insurance, and seaports. **Reports** resisted the temptation to draw global inferences about California problems from the recent Los Angeles riots. Property- and life-destroying riots obviously aren't a plus for economic development nor a tribute to the administration of the city or state, but it is hard to assert that such situations couldn't or won't arise in other states.

Changing Economic Fortunes: The Department of Commerce released personal income statistics on 4/22, using the fixed-weighted price index for the 4.1% inflation comparison.

Who Votes: The Census estimates of voting age population and turnout appear in Projections Of The Voting Age Population For States. Census issued its estimates of 1991 population by age for states in a press release (4/16). Use of females in the state table exaggerates population aging somewhat.

Education Reform: The National Education Goals Report (1991) and other materials on the national goals are available from the U. S. Department of Education or NGA. The quoted study of reform is from the Consortium for Policy Research in Education (c/o Eagleton Institute, Rutgers U., 90 Clifton Ave., New Brunswick, NJ 08901), Education Reform From 1983 To 1990 (12/92).

The Census Bureau (11/14/91 release) provides 1989 data on the percentage of residents who are high school graduates. SAT scores aren't directly comparable because differing percentages of students take the test. States In Profile combines rankings from SAT and ACT tests. Another approach, used in the table, adjusts the SAT ratings (see USA Today, 9/24/91). The math scores come from the National Assessment of Educational Progress, with an adjustment to ranks among 50 states rather 34 participating.

Miscellany: The not-for-profit NC Center for Public Policy Research (P. O. Box 430, Raleigh, NC 27602) issued its rankings in a press release (4/2). The study of California's welfare-to-work program, GAIN: Program Strategies, Participation Patterns, and First-Year Impacts In Six Counties is the product of Manpower Development Research Corp. (3 Park Ave., New York, NY 10016).

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VOLUME 10 ISSUE 11

IN THIS ISSUE

Major contradictions are appearing in state policy. State officials are committed to slowing the growth of property taxes and health care costs. But decisions cutting local aid and taxing health providers are accelerating their growth. State policies seek *both* rapid expansion of Medicaid and control of its cost.

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- Increasing And Cutting School Aid p. 3
- Raising And Lowering Property Taxes p. 6
- Raising And Lowering Health Costs p. 7
- Cutting And Expanding Medicaid p. 10

The contradictions reflect one overriding conflict. This year's state decisions seek ways to avoid *both* tax increases and spending cuts.

- Avoiding Tax Increases *And* Spending Cuts p. 14

A new report card on state development and new data on which states are attracting corporate headquarters provide inconsistent results.

- Attracting Corporate Headquarters p. 17
- The 1992 Development Report Card p. 19

A proposal for Chicago to become the third national center of casino gambling has major implications for other states.

- The High Stakes In Chicago Casinos p. 21

Federal grants rose in FY 1991 by more than 20% in a dozen states with most of the action in Medicaid. Some of the largest increases were to states with histories of low per capita grants.

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June 1992 (First Of Two June Issues)

CONFLICTS IN STATE POLICY

Where Have All The Trends Gone?

In the 1980s, it was often accurate to describe state policy changes as trends. Policies of most states seemed to move in similar directions in response to similar problems. Leaders of states that were behind national trends often described their efforts as *modernization*, *coming into the 20th Century*, and *catching up*. Most of the trends had names, such as *deinstitutionalization*, *equalization*, and *circuit breakers*. Many were called *reform*, like education reform, tax reform, and welfare reform. Not everyone meant exactly the same thing by these terms, but similarities were more noticeable than differences.

Such trends aren't the pattern in 1992. Why? First, many of the changes are inherently expensive. Others are made expensive by the common practice of providing new money for changes and holding harmless those who lose. Tight fiscal conditions have slowed the spread of cost-increasing policies and produced retreats from past policies. Second, some of the major premises are being questioned. Third, in the midst of strong anti-incumbent sentiment, legislators have been reluctant to adopt changes and participate in the long, acrimonious legislative sessions that seem inevitably to precede them.

So far, the results cannot be called trends. Not all states are moving in the same direction. In the situations featured in this issue, there is clear contradiction between widely accepted prescriptions of what should be done and what is actually being done. State policy can be seen moving in two directions at once in: (1) increasing (and decreasing) the state role in school finance, (2) raising (and lowering) property taxes, (3) raising (and lowering) health care costs, (4) cutting (and expanding) Medicaid, and (5) avoiding both tax increases and spending cuts despite structural deficits.

Rest In Peace: Multiple Reforms In Alabama

In mid-May, omnibus reform legislation died in Alabama with the decision not to bring the House-passed measures to a vote in the Senate. The legislation began as a 33-bill package bringing the state more into conformity with changes over the past two decades in other states. It included budget reforms, tax reform, education reform, and management practices. The package was touted as *modernization* needed to make Alabama competitive with other states in its school systems, management, and tax policy. This "noble effort," as the speaker called it, appears dead, at least for 1992.

The package died of love and hate. Opponents of change and of new taxes were never interested. Reformers lost much of their zeal as provisions were successively watered down. Yet that zeal would have been required to campaign for the voter approval needed for the many constitutional changes required to implement the plan.

INCREASING AND CUTTING SCHOOL AID

A Greater State Share, The Once Attainable Goal

The goal of expanding state aid for schools was almost an article of faith in the 1980s. The advantages seemed overwhelming: (1) equalization among districts of differing fiscal capacity, (2) lower reliance on property taxes, and (3) a basis for increasing state control to implement mandates for quality including class sizes, minimum teacher salaries, and uniform testing. The goal of raising the share of school costs paid by state funds is universally accepted by education interests and nearly universally supported by campaign commitments of elected officials. In many states, it is enshrined in reports of blue ribbon task forces and even in school finance legislation.

During the 1980s, increasing the percentage of school costs covered by state aid appeared to be an attainable objective. Enrollments were stable, with the total public enrollment in FY 1988 actually smaller than FY 1982. State revenues were growing rapidly without tax increases because of steady national economic growth. If total spending growth could be constrained by the good sense of local school officials and/or property tax limits, the state share could increase without increasing the percentage of state budgets going to public schools.

Nationally, the state share of total school costs (including a stable federal component of 6-7%) did grow from 47.9% in FY 1982 to 48.9% in FY 1991. Two factors kept growth from being more rapid. First, local school officials raised per pupil spending considerably more rapidly than inflation as they took advantage of rapidly rising property values to gain proportional revenue increases without raising tax rates. From FY 1983 to FY 1990, spending per pupil rose by 7.7% per year. Second, some states were backsliders in relation to the national trend, allowing the local share to increase.

Obstacles Appearing

Several factors combined to make achievement of greater state shares of education costs more difficult. The first was the resumption of enrollment growth. In the four years from FY 1988 to FY 1992, enrollment grew by 1.8 million students, a 5% increase. The second was worsening state fiscal circumstances. Spending for double-digit increases in corrections and Medicaid put pressure on funding for education. Another subtle factor has been the way the outstanding investment performance of teacher and school employee retirement plans has played out in school funding. This performance has permitted lower employer contributions to the plans, resulting in extra money being available for noticeable operating costs, such as teacher salaries. Many states have taken advantage of this to cut their own costs (where they pay the employer contributions) or rationalize smaller increases in state aid (where districts pay the employer contributions).

State Patterns Vary

In FY 1992, according to new National Education Association estimates, there was an actual decline in the state share of local school receipts. The uneven pattern among the states appears in the table. The percentage change in state aid is shown as a share of the total. For example, the national total moved from 48.9% to 48.3%, so the entry is -0.6%.

Change In State Percentage Of Total School Operating Costs, FY 1991 FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arkansas	2.8%	16	New Hampshire	0.1%	34	South Carolina	-0.9%
2	Idaho	1.8	16	Oregon	0.1	35	Mississippi	-1.0
3	Wyoming	1.7	26	Texas	0.1	35	Missouri	-1.0
4	Oklahoma	1.5	26	Utah	0.1	36	Rhode Island	-1.0
5	Hawaii	1.1	22	Alaska	0.0	38	Connecticut	-1.2
5	Wisconsin	1.1	22	Florida	0.0	39	Illinois	-1.3
7	Nebraska	0.9	22	West Virginia	0.0	40	Alabama	-1.5
8	Maryland	0.8	25	Ohio	-0.1	41	Arizona	-1.6
9	New Jersey	0.7	26	Indiana	-0.3	42	Montana	-1.7
10	Iowa	0.6	27	California	-0.4	43	Virginia	-2.3
10	Kentucky	0.6	27	Delaware	-0.4	44	Kansas	-2.6
12	Vermont	0.4	27	Georgia	-0.4	45	Maine	-2.8
13	North Carolina	0.3	37	Louisiana	-0.4	46	Nevada	-2.9
14	Pennsylvania	0.2	37	New Mexico	-0.4	47	Tennessee	-3.0
14	Washington	0.2		**United States**	**-0.6**	48	Massachusetts	-3.3
16	Colorado	0.1	32	North Dakota	-0.8	49	Minnesota	-3.5
16	Michigan	0.1	32	South Dakota	-0.8	50	New York	-3.6

The big story in the table is the significant shift toward local responsibility for school costs taking place in a single year. With the federal share a constant 6.2%, the drop in the average state share was associated with an increase of 0.6% in the local share. Nationwide, in order to achieve the actual 6.2% increase in school revenues, local effort was $1.3 billion more than would have been necessary if the states collectively had maintained their share.

There are special stories associated with almost all the states showing increases of 0.3 or more. The usual story is a large state tax increase for schools like those in **Arkansas**, **Oklahoma**, and **Nebraska**. In a few states, particularly **Hawaii** and **Idaho**, 1980s-like prosperity permitted 1980s-like school increases without state tax hikes. The stories associated with the reductions of 1% or more are generally all the same. State officials held a no-new-tax posture in the face of fiscal pressures by cutting their historical sharing of school costs. In a few cases, like **Rhode Island**, the fiscal problems were so serious that the state cut the state share and raised taxes.

State Shares Dropping Again This Year

From a survey of legislative leaders late last year, NCSL staff members predicted the higher-than-normal resistance to tax increases this year. Coupling this knowledge with the mathematics of state budgets, they predicted 1992 would be a tough year for education. NCSL's fiscal affairs director Ronald Snell wrote in The Fiscal Letter (Jan.), "the relatively small amounts that can be squeezed from income-support and optional Medicaid programs suggest that governors and legislators will have to turn to education cuts if taxes are indeed to be held down." NCSL fiscal analyst Tony Hutchison told a February school finance conference, "Larger than expected increases for social services, coupled with the downturn in the economy makes education very vulnerable in most states."

The table shows the variation in state responsibility for school costs. Most states are below 50%, although some pass this mark if federal aid is excluded. The table reflects the long-standing pattern of higher state shares in the South and the lowest ones in the Northeast and Midwest.

Percentage Of School Revenues From State Government, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	92.4%	18	Mississippi	52.5%	34	Connecticut	40.4%
2	New Mexico	75.8	19	Wyoming	52.5	35	Rhode Island	40.0
3	Washington	74.0	20	Iowa	52.0	36	Colorado	39.5
4	Kentucky	69.4	21	Florida	51.8	37	New Jersey	39.0
5	Delaware	67.6	22	Minnesota	51.6	38	Maryland	38.7
6	North Carolina	67.0	23	South Carolina	51.5	38	Nevada	38.7
7	West Virginia	66.9	24	Maine	48.3	40	New York	38.4
8	California	66.5		**United States**	**48.3**	41	Missouri	37.9
9	Alabama	65.1	25	North Dakota	47.8	42	Vermont	37.4
10	Alaska	63.6	26	Pennsylvania	46.9	43	Michigan	35.5
11	Idaho	63.5	27	Texas	44.8	44	Illinois	35.4
12	Oklahoma	62.9	28	Montana	44.5	45	Massachusetts	33.6
13	Arkansas	62.8	29	Tennessee	44.4	46	Virginia	33.2
14	Utah	57.1	30	Ohio	42.7	47	Oregon	26.8
15	Indiana	56.1	31	Wisconsin	42.0	48	Nebraska	26.7
15	Louisiana	56.1	32	Arizona	41.6	49	South Dakota	26.0
17	Georgia	52.9	33	Kansas	41.5	50	New Hampshire	7.6

It is unlikely that these shares are being maintained by actions on the FY 1993 budgets in most states for the reasons predicted by the NCSL staff members. Even scheduled increases, such as those of **Colorado** and **New Jersey**, are being scaled back. Legislators have also discovered that equalization mandates can be handled through formula changes increasing local effort and by spreading tax bases, as well as with higher state aid.

RAISING AND LOWERING PROPERTY TAXES

The reasons for reducing reliance on property taxes complement those for a higher state share of school costs. Public opinion polls consistently show property taxes to be less popular than state sales or income taxes. High local reliance on property taxes creates strong pressures for state actions to offset resulting problems: (1) cutting state revenue by circuit breakers and other ways of offsetting property tax payments against state tax liabilities, (2) eliminating taxes considered inimical to business development, particularly taxes on business inventory, machinery, and equipment, and (3) providing special equalization payments for municipalities with low property tax bases and/or extraordinary concentrations of tax-exempt property. In addition, the 1980s saw many states taking over, or increasing their share of funding for, previously local functions including general assistance, certain indigent health costs, courts, and a portion of local corrections costs.

No doubt, a majority of state legislators believe that state policy should be moving toward less reliance on property taxes. Yet, just the opposite has been happening. The trend was already apparent in the pre-recession state and local decisions affecting FY 1990. In that year, property tax revenues rose by 9.3% while overall state and local revenue rose by a lesser 7.9%. The latest estimates show a property tax revenue increase in the first quarter of 1992 of 6% over the same quarter a year earlier. That compares with an increase of 6.9% in sales tax revenues but only 4.3% in personal income taxes.

As recovery proceeds, income and sales tax receipts are likely to grow faster than property tax receipts. The income and sales receipts will reflect economic growth and state tax increases. The property tax revenues will reflect, with a lag, the slowdown in business investment and declining property values in some regions and sluggish increases in others.

But property tax growth could be fanned by new rounds of local rate increases associated with a decline in state school aid and state and federal aid for cities and counties. That state aid is under pressure from fiscal circumstances. There is also concern in some states that state aid has provided inappropriate incentives for local officials to spend too much because they are using other peoples' money. The shift has been dramatic in Boston. It got 61% of its revenue from property taxes in 1981. The percentage dropped to 35% in 1989, but has already increased to 44%.

Sometimes the conflicting approaches to property taxes are apparent in the same year in the same state. For example, this year Illinois' governor has made recommendations which will continue to shrink the percentage of school costs paid from state funds and sharply cut aid to cities and counties. Yet Illinois legislators have put a constitutional amendment on the November ballot to mandate that the state cover at least 50% of school costs, up from about 33% now, and to mandate equalization measures which the state's highest court has held the present constitution doesn't require.

RAISING AND LOWERING HEALTH COSTS

States will have an important role to play in health care reform. However, the Medicaid experience teaches us that if we want adequate basic health care coverage for all Americans, we cannot ask the states to finance it.

While state officials everywhere are talking about ways to slow the escalation of health care costs, they are adopting health care provider assessments that are adding to the costs of hospital services to customers. The changes are occurring rapidly, but so subtly that few people recognize the revolutionary changes taking place in financing indigent health care.

Those changes reflect the perspective of many different actors in health care finance, all reaching the same conclusion as U.S. Representative Henry Waxman, quoted above. They believe that the states cannot be asked to finance widespread basic health coverage. Waxman, who is the author of many Medicaid mandates, sees decisive national action as the answer. State officials are increasingly forcing an answer by refusing to use state general fund resources to fund Medicaid cost increases. As a result, many states are successfully shifting those costs to: (1) all consumers of health care through state taxes on health services, and (2) the federal government.

Tennessee As The Advance Force

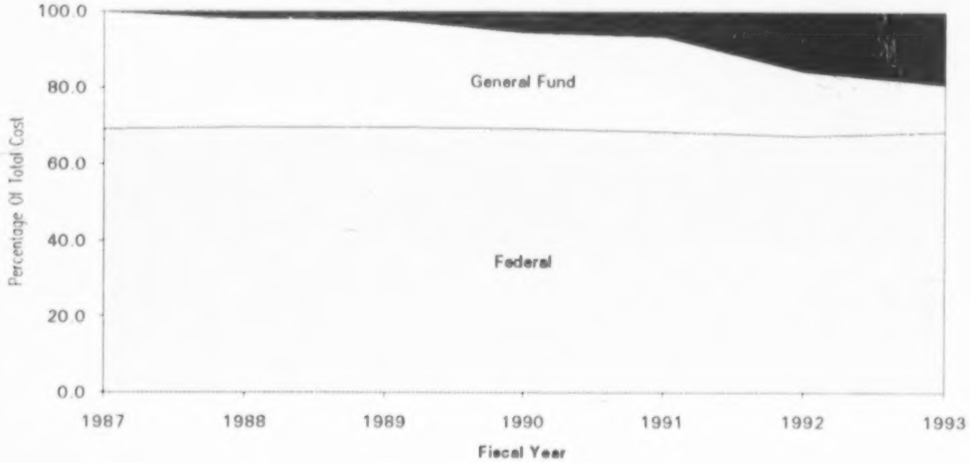
Tennessee has been a consistent pioneer in bootstrap financing -- ways to pay for Medicaid without forcing increases in state taxes. Before other states started using devices like provider donations, Tennessee was using them and standing firm in the face of opposition by federal officials seeking to avoid their budgetary impacts. Last year's federal attempt to limit Medicaid reimbursements was squarely aimed at some of the state's practices. The compromise legislation passed last year forced changes in the practices of few states, mostly just cutting off ideas that would soon be implemented. In Tennessee, it forced revision of established patterns of Medicaid finance.

This development, a sluggish economy, revenues dependent on a sales tax that doesn't respond well to the growth that does occur, and a desire to finance education reform all led the governor to push for an income tax. Tax-shy Tennessee legislators substituted a sales tax increase for the governor's income tax proposal and adopted a scaled-down version of education reform, but will probably revisit the tax issue next year.

Even the governor's tax proposal was *not* designed to increase state tax revenues for Medicaid. The new revenue would have been used for more popular objectives, lowering the sales tax and increasing education spending.

With a smaller sales tax increase, Tennessee legislators were even less inclined to allocate new general fund money to Medicaid. They didn't. Instead they worked with provider groups to devise an arrangement that *reduces* the share of Medicaid costs paid from regular tax revenues by continuing to rely upon dollars furnished by the providers, principally hospitals. The results can be seen in the patterns of Medicaid finance shown in the chart.

Reducing Reliance On Taxpayer Funding Of Tennessee Medicaid Costs



The chart shows constant federal cost sharing and consistent Tennessee success in reducing the state hard dollar share. The difference is the increasing percentage of funding supplied by health care providers. Big money is involved in the state provider assessments. The tax on hospitals will be 6.75% of gross revenues. The nursing home tax will average about $2,600 per bed-year.

The FY 1993 financing plan as presented in the chart is in violation of a federal limit on the portion of the state-funded share that can be covered by provider levies, which Tennessee officials view as limiting those levies to 48% of the state match. The solution is to package a portion of the provider assessments as broad-based taxes. Specifically, there is a new business privilege tax which applies to medical services and non-medical services such as pool halls and trailer parks. **But** other businesses get to credit their privilege tax payments against their sales tax obligations.

Variations On Provider Financing Plans

The economic effect of the new Tennessee plan is for providers to pay all of the net revenues generated by the new tax. But the legal form is different, so Tennessee will attempt to qualify its levy. Tennessee officials recognize a significant possibility that the new plan will be rejected. However, it is entirely possible that the Bush Administration will not want to reject a state Medicaid plan this fall. Arguments against rejection: (1) Rejection, which would be characterized as limiting state experimentation and causing low income people in Tennessee to lose health coverage, is the wrong thing to be doing before a Presidential election, (2) Health care generally shouldn't be addressed until 1993 and when it is addressed should be considered on a much broader basis than accepting or rejecting Medicaid plans of a few states, (3) Even if health care issues aren't to be addressed comprehensively in 1993, Medicaid issues will have to be, so action on Tennessee alone doesn't make sense.

Even if an administrative rejection is in the offing, Tennessee could seek to delay the effects of administrative action by seeking a Congressional moratorium, a strategy used in 1991, and it could litigate in the federal courts. **Even if forced back to the drawing boards by a federal rejection, Tennessee has more cards it could play.** For example, it could take credit for some tax-like devices it already uses (see Technical Notes).

Rhode Island As An Example

Like Tennessee, Rhode Island is trying to dig out of a large fiscal hole. Rhode Island's was caused by one of the nation's worst-performing economies and a state bailout of failed financial institutions. Rhode Island legislators haven't acted yet, but will probably find they have little choice other than the governor's recommendations for a collection of small tax increases and continued austerity. In FY 1993, Rhode Island may well be providing 75% less non-education aid to local governments than five years ago.

The governor's fiscal proposals have *not* included Medicaid as a beneficiary of proposed tax increases nor provided room to continue current Medicaid eligibility and services without new provider levies. While there are many locally significant disputes among and within health provider groups, they seem to recognize the choices they are being presented: (1) provider taxes combined with no curtailment of eligibility and constant or higher reimbursement rates, or (2) no provider taxes, reduced eligibility, and frozen or reduced reimbursement rates. Given these choices, which are vividly presented by the governor's budget proposals, there is a good chance that providers will elect the combination of provider taxes and higher reimbursement rates.

Other State Developments

There are developments similar to those in Rhode Island in many other states. State fiscal officials and health care providers are nervous over the provider tax proposals. However, preliminary budget discussions in nearly every state have shown strong legislative opposition to pre-election tax hikes for any purpose and even stronger opposition to tax hikes that would be justified as funding Medicaid. As providers recognize there is no alternative of continuing Medicaid without any pain, the alternative of continuing Medicaid with provider taxes looks more attractive.

There has been a revival of interest in some states in the health planning measures of the 1970s that were designed to control health care costs by requiring state approval of capital outlays. The concept is that providers will overinvest in expensive equipment and in nursing home and hospital bed capacity and then recoup the costs of excess capacity by excess utilization. Regardless of the merits of these controversial controls, the most optimistic view of savings is far less than the clear cost increases being imposed in provider taxes.

CUTTING AND EXPANDING MEDICAID

Medicaid Cuts Being Avoided

> *There is no reason the inflation rate {of health care and Medicaid costs} should be three times inflation. We need to put a tourniquet on to stop the hemorrhaging.*

These comments by Ohio's Governor Voinovich on the TV program Ohio Today in late May are typical of those of elected officials complaining about sharply escalating Medicaid costs. These concerns are in direct contradiction of the forces now playing on state officials. **Those forces strongly encourage state decisions that are raising Medicaid costs faster than would be required to cover both increasing caseloads and the inflation in health care costs.**

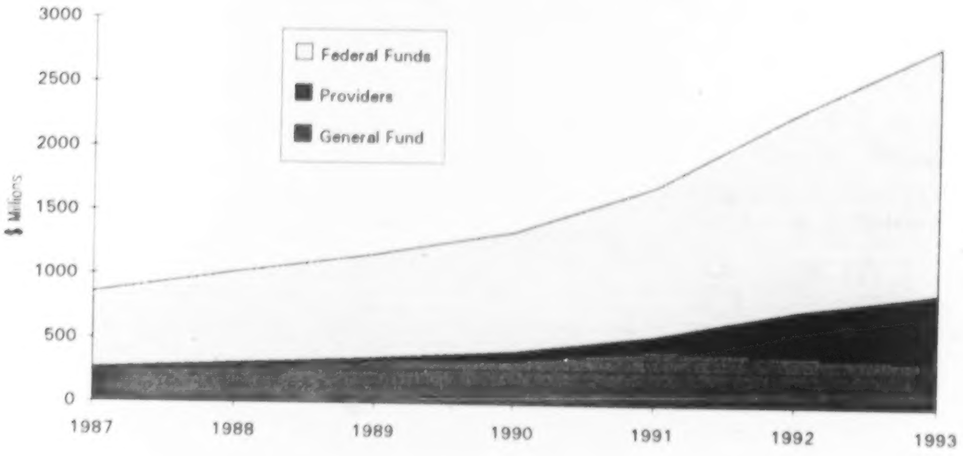
The reimbursement rate increases are frequently greater than rate increases affecting private-pay patients. This is because the rate increases are serving two purposes beyond meeting increasing costs: (1) making peace with hospitals and other providers to eliminate litigation under the Boren Amendment cases that apparently give providers standing to seek higher Medicaid reimbursements in the courts and (2) providing incentives for hospital and other provider associations to convince their members to accept provider taxes to fund Medicaid.

State Medicaid costs are also being systematically increased by decisions to shift from 100% state and private patient funding to Medicaid funding. One example is provided by Ohio, which deliberately increased its Medicaid costs, though this, of course, wasn't the objective. The objective was cutting the budget. The complex math begins with the elimination of about $140 million a year in state-funded payments to hospitals under the General Assistance medical program. The state's saving is not the hospitals' loss. They get an estimated $202 million in funding from the new "Care Assurance" program, Ohio's special title for bootstrap financing. A substantial number of patients lose their cards under the now defunct 100% state program, but get new health care cards through Medicaid.

Outcomes like these permeate decisions at many levels in most states. Another example is university hospital finance. In New Mexico, the state university hospital is getting about $28 million in private insurance payments in FY 1992, up only slightly from $27 million in FY 1987. In the same period, Medicare reimbursements grew from $13 million to $22 million, a 69% increase. The big gain was in Medicaid, rising from $11 million to $34 million, a 209% increase.

One impact of the decisions is shown in the chart below. It traces the escalation of Tennessee total Medicaid costs and the amounts being provided from the state, providers, and the federal government. It shows state costs dropping but total costs rising rapidly.

Raising Total Medicaid Costs
While Cutting State Government Costs,
Tennessee, FY 1987 To FY 1993



Medicaid Issues In Three States

Most states take the Medicaid program for granted and argue at the margins about funding sources, eligibility, services, and cost controls. More fundamental issues are being aired in **Arizona**, **Colorado**, and **Oregon.**

Avoiding Medicaid In Arizona: Health care for the poor is a major source of difficulties in the Arizona budget. It has been the only state without a Medicaid program. Instead, it has something that by its title -- the Arizona Health Care Cost Containment System -- is designed to avoid runaway costs. Decisionmakers viewed Medicaid as so inherently costly and intrusive on the state's health care system that they decided to forgo the federal cost sharing and pay for health care with 100% state and local money.

Isolation from Medicaid was expensive for Arizona and embarrassing for proponents of the federal program, so the state has been qualifying some of its activities for Medicaid. In federal FY 1991, Arizona received $139 per capita for Medicaid. The national average was $205. The AHCCCS program now (FY 1992) represents 10.5% of the budget, making it what the House Ways and Means Chairman calls the "black hole" in the budget.

One of the proposals that makes tax cuts possible in the governor's budget involves shifting substantial indigent health costs to county governments. Another approach being seriously debated is to drop the automatic coverage of certain persons in the age group 21-65, unless they meet the qualifications for federal cost sharing under Medicaid.

Eliminating Medicaid In Colorado: Dropping Medicaid entirely was debated seriously in Colorado this year. The idea sounds so appealing to frustrated legislators that NCSL recently devoted a national meeting panel to it. The idea will be considered further in Colorado based on legislation passed this session.

Colorado legislators are frustrated because many of them have signed onto two major policies: (1) a revision of the school aid formula with automatic escalation of state funding that passed several years ago and (2) no state tax increases. Last year they slid by with a scaling down of some of the promised education increases. This year the problem was worse. The outcome was austerity in other programs, limited educational increases, and a breaching of the no-new-tax policy. The governor is so dissatisfied with the result that he is pushing an initiative for the November ballot to raise the sales tax by one cent.

Medicaid Rationing In Oregon: The health care plan in Oregon limits the services available to Medicaid recipients to conform to appropriations. It has received nationwide attention as a potentially better approach that controlling costs by reducing the number of poor eligible for the program or reimbursement rates so low they require cross-subsidies from other health care customers.

After a false start in developing the priority list of services, the plan now awaits a federal decision on granting a waiver from the many Medicaid policies it violates, such as one indicating that services for the poor under Medicaid shall be comparable to those available to paying patients. The Secretary of Health and Human Services has promised a decision by the end of June.

It isn't obvious that Oregon will implement the plan even if it gets approval of the waiver. In 1993, when it considers the first major budget embodying the plan, Oregon legislators will also be seeking to deal with voter-initiated Measure 5. It seems to commit a substantial portion of the state's budget, off the top, to replacing local school property tax revenue lost to Measure 5 rollbacks. The governor has already announced that 4,000 employees will be dropped from the state's payroll in anticipation of the fiscal effects.

Assessing The Escalating Costs

State Medicaid spending numbers cannot readily be compared because of differing practices in what is included in the budget and when spending is recognized (e.g., accrual v. cash). But federal reimbursement timing and concepts are the same for all states, so Medicaid spending changes can be tracked by looking at the changes in the federal match as done in the table below.

Percentage Change In Medicaid Federal Grants, FY 1990-FY1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Missouri	77.7%	18	Alabama	33.0%	34	Iowa	25.0%
2	New Hampshire	68.9	19	Pennsylvania	32.4	35	Virginia	25.0
3	Wyoming	60.7	20	Florida	31.6	36	Oklahoma	24.6
4	West Virginia	49.4	21	Kansas	30.8	37	South Dakota	24.4
5	Louisiana	47.1	22	Mississippi	29.5	38	New York	23.4
6	Delaware	45.0	23	Montana	29.3	39	Minnesota	21.4
7	Nevada	44.6	24	Idaho	29.2	40	Ohio	20.4
8	South Carolina	43.4	25	Michigan	29.1	41	North Dakota	20.1
9	Kentucky	42.9	26	Oregon	28.8	42	Wisconsin	20.0
10	Rhode Island	41.9		**United States**	**28.6**	43	Indiana	19.9
11	New Mexico	39.4	27	Connecticut	28.3	44	Arkansas	19.8
12	Texas	39.1	28	New Jersey	27.8	45	Washington	19.4
13	Maine	38.7	29	Vermont	27.7	46	Hawaii	18.1
14	Colorado	38.6	30	Arizona	27.3	47	California	17.1
15	North Carolina	37.8	31	Maryland	26.4	48	Alaska	12.6
16	Tennessee	34.7	32	Nebraska	25.1	49	Illinois	12.1
17	Massachusetts	33.9	33	Georgia	25.0	50	Utah	11.5

The table shows federal (and thus state) Medicaid cost escalation that averaged nearly 30% in FY 1991. While the federal estimates aren't in yet for FY 1992, results to date suggest that another escalation in the 25-35% range is taking place this fiscal year.

As shown on the table, only eight states experienced an increase of less than 20%, less than the number that increased spending by more than 40%. The second important aspect is the identity of the states that have felt the most fiscal pressure. States with relatively generous Medicaid programs -- including California, Hawaii, and New York -- show increases well below the national average. States with traditionally low spending on Medicaid appear near the top of the rankings. The major reason is the impact of federal mandates. They have had little effect on the more generous states, but have forced major increases in Medicaid eligibility in the states that have maintained the lowest cost programs.

Fear And Trembling

State officials are, to put it mildly, nervous about the rapid developments in Medicaid finance. The statements below are from legislators during the Tennessee House debate on Medicaid finance. The first two are from John Bragg, the House Finance Chairman who has long been active in NCSL activities. The rest are from other legislators.

> *We continue to dig a hole that is going to bury us.*
>
> *In two years, our Medicaid bill has gone up $1.1 billion. Next year, it is going up $500 million. We are living in a dream world on this Medicaid program.*
>
> *This thing is just about to eat us up. We put money in. It grows bigger, and we haven't solved anything.*
>
> *There is too much gold in this thing for too many people.*
>
> *The plan we had before was considered a ruse and a subtrafuge. We took federal dollars and matched them with federal dollars. Many other states used the same ruse.*

AVOIDING TAX INCREASES *AND* SPENDING CUTS

Legislators in many states have taken the implicit advice of press criticisms of their actions last year as too partisan, too lengthy, and too disputatious. This year they are adopting budgets with a minimum of dispute and a maximum of dispatch and getting out of town fast. Examples are **Iowa**, **Maine**, **Minnesota**, **Washington**, and **Wisconsin**.

Achieving this objective requires that policy disputes be minimized by avoiding the sharp changes in policy that tend to make for bitter disputes and long sessions. The list of what to avoid includes tax reform, large increases in general taxes, school aid formula revisions, and massive cuts in state programs. Austerity without changes in program concepts is much more acceptable. As a result, much less has been heard about major spending retrenchments this year than last year.

One group of exceptions are the states where a major tax increase has been proposed, but may not be enacted. In those states, the debate centers first on the tax increase with the retrenchments to be discussed later. **Tennessee** began its session that way along with **Maryland** and **Florida**. In both Maryland and Tennessee, legislators were presented a choice between: (1) a budget with no new taxes and sharp spending cuts and (2) a relatively generous alternative proposed by the governor. In both states, they rebelled at both alternatives and adopted more austere budgets and smaller tax increases. The issue in Florida is still in doubt.

The other group of exceptions are the states where a major political force is making a run at significant spending cuts and forcing tax cuts -- **Massachusetts**, **Michigan**, and **New Jersey**.

In **Massachusetts**, income taxes have already dropped slightly. This could make the Bay State the only one in the union to drop taxes this year as seen by **Reports** and taxpayers. {Believers in scheduled future rate reductions won't count the Massachusetts action as a tax cut and will blame New York for a massive tax increase for not implementing scheduled reductions.} Agreement has been reached on consensus tax collection estimates for FY 1993 *above* those in the governor's budget. There is still concern that non-tax revenues are overestimated and spending underestimated.

The added tax cuts recommended by the governor remain a serious possibility, though the budget being developed in the legislature doesn't include them. As described by the Boston Globe (5/16), the legislative approach is low key and incremental, avoiding controversial budget cuts and proposed tax changes.

> *But unlike the last three years, no one appears to be talking about the need for wholesale reforms in the "budget buster" accounts that dominate state spending, such as the $2.8 billion Medicaid program, $800 million Aid to Families with Dependent Children and the $400 million Massachusetts Bay Transportation Authority deficit. Likewise, in the biggest state agencies, such as the Correction, Mental Health and Mental Retardation departments and state colleges and universities, the budget debate will generally be whether to add a few million dollars here or there over current spending levels.*

Michigan's fiscal outlook has deteriorated so badly that tax cuts appear unrealistic. The governor's budget is tight, but didn't match last year's for sharp cuts, like those made in the general assistance program. Instead, his emphasis has been on cutting and capping local property taxes. Democrats in the legislature have a plan of their own. The outcome is likely to be that both parties will take a record of unsuccessfully trying to force local tax cuts to voters in November, blaming the other party for their lack of success.

In **New Jersey**, legislative Democrats are now in a minority in the aftermath of their support of the large tax increases of 1990. Their posture is recognizing the loss and challenging the new majority to make sense of state policy. As the Democratic leader in the Senate recently put it:

> *Somebody really should figure out a way to tell the Republicans that the campaign is over. This insistence on rehashing campaign cliches won't do after voters gave them a mandate to govern.*

To govern through their veto-proof legislative majorities, the Republicans need both a fiscal plan and enough cohesiveness in voting to enact it without help from the Democratic minorities and Governor Florio (D). Problems are arising on both fronts. The cornerstone of the fiscal plan is a rollback of the one-cent sales tax increase, but not the other parts of the tax increase package. With a tight budget overall, the fiscal building that went with this cornerstone needs some major building blocks including ways to defer spending increases and real spending reductions.

The governor preempted many of the spending deferrals in his budget proposal. Defense against spending reductions, particularly in support of the large property tax rebate program, has been stiff. The environment turned worse in May with announcement of major shortfalls in revenue in FY 1992 and relative to the budget levels for FY 1993. The governor's veto of the sales tax reduction has been overridden.

Two other states might see tax reductions this year, but not in circumstances where they could be cited as examples of budget cutting led by elected officials. When **Missouri** voters rejected the tax increase on the 1991 ballot, they also rejected extension of some temporary levies. Unless the governor and legislature agree on a smaller tax package not requiring voter approval, these tax rates will drop automatically. **Pennsylvania** taxes would also drop pursuant to scheduled reduction, which the governor's budget recommends take place on schedule. Even with the reduction, the massive 1991 tax increase will largely be left intact.

What happens when state officials can't conceivably adopt a new budget without the tax increases or sharp spending cuts being avoided in most states? No one knows. The test case is **California** where no solutions are appearing for the deteriorating fiscal situation.

ATTRACTING CORPORATE HEADQUARTERS

Corporate headquarters are economic development prizes. They are prestigious clean industry with high paying jobs and often are associated with supporting activities such as R&D centers. The table shows the concentration of **Fortune**'s (4/20) 500 company headquarters. They are highly concentrated in a few of the largest states, with the largest numbers in Northeastern and Midwestern industrial states. Ten states have none.

Headquarters of Fortune 500 Companies, 1991

State	Number	State	Number	State	Number	State	Number
New York	56	Massachusetts	15	North Carolina	5	Nebraska	3
Illinois	46	Virginia	13	Oregon	5	Arizona	2
California	44	Missouri	12	Washington	5	Kansas	2
Texas	39	Wisconsin	12	Arkansas	4	Kentucky	2
Ohio	34	Georgia	11	Delaware	4	New Hampshire	2
Pennsylvania	34	Indiana	11	Louisiana	4	Tennessee	2
Connecticut	28	Florida	7	Maryland	4	West Virginia	2
New Jersey	22	Colorado	6	Oklahoma	4	Idaho	1
Michigan	20	Alabama	5	Rhode Island	4	Mississippi	1
Minnesota	16	Iowa	5	South Carolina	4	Utah	1

The picture changes considerably when the number of headquarters is related to each state's population. Connecticut ranks highest because of the many corporations it has drawn to Fairfield County just outside of New York City. Eastern industrial states generally do best, while California and Southeastern states are below the national average.

Fortune 500 Corporate Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Connecticut	8.5	15	Virginia	2.1	28	West Virginia	1.1
2	Delaware	5.9		**United States**	**2.0**	29	Washington	1.0
3	Illinois	4.0	16	Indiana	2.0	30	Idaho	1.0
4	Rhode Island	4.0	17	Nebraska	1.9	31	Louisiana	0.9
5	Minnesota	3.6	18	New Hampshire	1.8	32	Maryland	0.8
6	Ohio	3.1	19	Iowa	1.8	33	Kansas	0.8
7	New York	3.1	20	Colorado	1.8	34	North Carolina	0.7
8	Pennsylvania	2.8	21	Oregon	1.7	35	Utah	0.6
9	New Jersey	2.8	22	Arkansas	1.7	36	Kentucky	0.5
10	Massachusetts	2.5	23	Georgia	1.7	37	Arizona	0.5
11	Wisconsin	2.4	24	California	1.4	38	Florida	0.5
12	Missouri	2.3	25	Oklahoma	1.3	39	Tennessee	0.4
13	Texas	2.2	26	Alabama	1.2	40	Mississippi	0.4
14	Michigan	2.1	27	South Carolina	1.1		All Others	0.0

A major headquarters relocation is a rare development coup. A more common method for a state to gain headquarters is for one of its companies to displace another from the top 500 by merger or by faster growth. From 1981 to 1991, 35 states have had changes in the number of the 500 headquarters. Most of the changes are small, but the movement away from New York and toward Texas is fairly dramatic, as shown in the table.

Change In Headquarters of Fortune 500 Companies, 1981 To 1991

State	Change	State	Change	State	Change	State	Change
Texas	13	Arkansas	2	New Jersey	1	Maryland	-2
Virginia	9	Louisiana	2	Utah	1	North Carolina	-2
Georgia	5	Nebraska	2	Kansas	-1	Tennessee	-2
Indiana	4	Washington	2	Kentucky	-1	Wisconsin	-2
Iowa	4	West Virginia	2	Michigan	-1	Connecticut	-4
Alabama	3	Colorado	1	Missouri	-1	Pennsylvania	-5
California	3	Delaware	1	Ohio	-1	Illinois	-7
Florida	3	Minnesota	1	Oklahoma	-1	New York	-33
Rhode Island	3	Mississippi	1	Oregon	-1		

As critics of "smokestack chasing" point out, Fortune 500 companies aren't major sources of net job growth. More rapid growth (and decline) is found among smaller companies. Capturing statistics on this growth isn't easy because much of the activity measured in standard statistics, such as business incorporations and failures, reflects the ebb and flow of competitors in local markets for restaurants and specialty retailers. One of many useful indicators is the Inc. Magazine (Dec.) version of the top 500, identifying the fastest-growing private companies. The location of these companies is much more likely to be in the South and West than the Fortune 500 companies.

Headquarters of Inc 500 Fastest Growing Private Companies, 1991

State	Number	State	Number	State	Number	State	Number
California	84	Arizona	12	Missouri	6	Mississippi	2
Texas	40	Indiana	12	New Mexico	5	Wyoming	1
Virginia	27	Colorado	11	Kansas	5	Vermont	1
Florida	25	Washington	11	Connecticut	5	Alaska	1
Massachusetts	22	Ohio	11	Tennessee	5	North Dakota	1
Pennsylvania	19	Georgia	9	New Hampshire	4	South Dakota	1
New York	19	Utah	8	Nevada	4	Rhode Island	1
Illinois	18	North Carolina	8	Nebraska	4	West Virginia	1
Michigan	17	Oregon	7	Delaware	3	Arkansas	1
Wisconsin	14	Kentucky	7	Idaho	3	Hawaii	0
New Jersey	14	Oklahoma	6	Iowa	3	Maine	0
Minnesota	13	Alabama	6	South Carolina	3	Montana	0
Maryland	13	Louisiana	6				

Relating state success in attracting and "growing" these companies to population, as shown in the table, presents a much different picture from that shown for the Fortune 500 companies.

Inc. 500 Corporate Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Utah	4.5	18	Washington	2.2	34	South Dakota	1.4
2	Delaware	4.4	19	Wyoming	2.2	35	Louisiana	1.4
3	Virginia	4.3	20	Indiana	2.1	36	Georgia	1.4
4	Massachusetts	3.7		**United States**	**2.0**	37	North Carolina	1.2
5	New Hampshire	3.6	21	Kansas	2.0	38	Missouri	1.2
6	Colorado	3.3	22	Oklahoma	1.9	39	Iowa	1.1
7	New Mexico	3.2	23	Kentucky	1.9	40	New York	1.1
8	Arizona	3.2	24	Florida	1.9	41	Tennessee	1.0
9	Nevada	3.1	25	Michigan	1.8	42	Ohio	1.0
10	Minnesota	2.9	26	New Jersey	1.8	43	Rhode Island	1.0
11	Idaho	2.9	27	Vermont	1.8	44	South Carolina	0.8
12	Wisconsin	2.8	28	Alaska	1.8	45	Mississippi	0.8
13	California	2.8	29	Pennsylvania	1.6	46	West Virginia	0.6
14	Maryland	2.7	30	North Dakota	1.6	47	Arkansas	0.4
15	Nebraska	2.5	31	Illinois	1.6	48	Hawaii	0
16	Oregon	2.4	32	Connecticut	1.5	49	Maine	0
17	Texas	2.3	33	Alabama	1.5	50	Montana	0

THE 1992 DEVELOPMENT REPORT CARD

The Report As A Sandwich: The CfED "report card" on state economic development is now in its sixth year. It is best understood as a sandwich. The meat in the 191-page report gets better every year. The report is a research source with solid, documented, and analytically useful statistics built on the same economic concepts that underlie state economic development policies. The relishes packaged with the meat in appendices are useful statistical approaches to three common state concerns: (1) the extent to which an economy is built upon strength in selling nationally and internationally traded goods and services, (2) the vulnerably of state economies to national economic changes, and (3) disparities between rural and urban areas in each state.

The bread is the ranking system itself, the press materials, and a short essay stressing six "lessons." These lessons aren't drawn from the data and are unlikely to commend themselves as useful to those who find the rest of the report useful. But the bread can be stripped and the meat savored for its quantity and quality.

Winners And Losers: Like a report card, the report doesn't provide one overall grade. Instead there are various subindexes that lead to three main grades which, for most states, are closely correlated: (1) economic performance, (2) business vitality, and (3) development capacity. The top and bottom states are shown in the table. Grade-point averages (A=3, F=-1) were supplied by **Reports**. There is no composite ranking in the report.

Grades In 1992 Development Report Card, Selected States

State	Performance	Vitality	Capacity	Average	Rank, PCI
Top-Ranked States					
Delaware	A	A	B	2.7	39
Maryland	A	B	A	2.7	40
Minnesota	B	A	A	2.7	28
Utah	A	B	A	2.7	9
Connecticut	A	B	B	2.3	44
California	C	A	A	2.3	45
Colorado	C	A	A	2.3	22
Selected Other States					
New York	C	C	A	1.6	29
Texas	D	A	B	1.6	17
Massachusetts	C	D	A	1.3	48
Pennsylvania	B	C	C	1.3	24
New Hampshire	B	D	C	1.0	50
Bottom-Ranked States					
Florida	C	C	D	0.6	38
Alabama	D	C	D	0.3	10
North Dakota	D	C	F	0.0	1
Arkansas	F	C	F	-0.3	12
West Virginia	D	D	F	-0.3	11
Mississippi	F	D	F	-0.6	14
Louisiana	F	F	F	-1.0	6

Getting a poor grade from CfED may indicate development success as voters and elected officials would measure it. The last column on the table shows state ranks in per capita income growth from 1988 to 1991 as shown in Issue 10. All six CfED bottom states placed in the top 15 by that measure. This suggests a poor CfED grade is associated with strong personal income growth.

All the bottom CfED states were in the top 30 in **Reports**' Index of State Economic Momentum (Issue 6). The average ranking of CfED's bottom-ranked states in the Index's job growth component was 16.3. Its top ranked states' average job-gain rank was a lower 28.6. So a poor report card is associated with strong job growth.

While it isn't a good predictor of development success of states, **the Report Card is probably a success given its objectives.** Before it was started, the Grant Thornton "business climate" rating was the only comparative statistic in town. Its focus is on minimizing cost for manufacturers. As a result, the Southeastern states rank high because of low wages, low taxes on manufacturing, and less generous programs for unemployment compensation and Workers' Compensation than Northeastern states. By using high wages as a plus rather than a minus and giving low grades for Southeastern problems like low educational attainment and high infant mortality, the Report Card reverses these results. The result is a standoff for those who like to debate state policies in terms of simple indices.

There is a wealth of data in the detailed report. There is no substitute for looking through the tables. For example, there one discovers that Mississippi and Louisiana are ranked first and second in manufacturing capital investment. The success of targeted development policy shows in commercial bank deposits per capita where Delaware and South Dakota lead by wide margins. Venture capital investments are greatest in Massachusetts, Rhode Island, and California.

THE HIGH STAKES IN CHICAGO CASINOS

> *The ~~moral question~~ is ended. We have a lottery. You can walk out of your home and go to a local grocery -- instead of buying some milk, buy a lottery ticket. You can go to off-track betting on State Street. You can float from Joliet going south, you can float all over the State of Illinois in gambling casinos.* -- Chicago Mayor Daley (4/2) announcing support for casino gambling.

The Illinois casino proposal has substantial implications for approval of gambling and finances in other states. Nevada and Atlantic City (NJ) still have an effective monopoly on destination-resort casinos within the U.S. Riverboat gambling on the Mississippi, gambling on Indian reservations, Deadwood (SD) and proposed extensions in many states, video poker, and charity casino nights all offer increasingly stiff competition, but none of these will draw large conventions. The Chicago plan would. It has backers with enough money to drop $2 billion on new facilities. Caesars World, Circus Circus, and Hilton Hotels are lined up and Hyatt Hotels is considering the $500 million ante.

Approval would have uncertain effects on casino proposals elsewhere, such as Cleveland and Detroit. On the one hand, it would tend to break the ice for other proposals much as lotteries became increasingly acceptable in reluctant states as other states approved them. The issue became not whether residents would gamble but whether they would spend their money in-state or elsewhere. On the other hand, a casino complex in Chicago would eat into potential markets for ones in Detroit, Cleveland, or other major cities.

Other Illinois gambling activities would probably suffer from casino approval, although there is plenty of room for dispute about which activities and how much. According to industry representatives and Governor Edgar, the horse racing industry, which has fallen on hard times for other reasons, would suffer. So would the nascent riverboat gambling industry, which is about to open two boats in Joliet, close to Chicago. More speculative is the effect on charity gambling and state lotteries.

FEDERAL GRANTS TO STATES

Federal grants to state and local governments are continuing to grow much faster than revenues those governments are raising from their own taxpayers. Grants in the first quarter of 1992 were up 17% from the same quarter a year earlier. The major reason is Medicaid. The latest state-by-state data are shown in the table below.

Percent Increase In Federal Grants To State And Local Governments, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Missouri	29.9%	18	Ohio	15.4%	34	Arizona	11.7%
2	West Virginia	27.3	19	Tennessee	15.2	35	Alabama	11.7
3	New Hampshire	26.5	20	Arkansas	15.1	36	Nebraska	11.4
4	Hawaii	23.6	21	Iowa	14.4	37	Wisconsin	10.3
5	Delaware	23.3	22	Mississippi	14.2	38	Washington	10.3
6	Nevada	23.1	23	Michigan	14.2	39	South Carolina	9.8
7	Louisiana	22.2	24	Indiana	14.2	40	New York	9.3
8	Massachusetts	22.1	25	Kansas	14.1	41	Maryland	8.8
9	Kentucky	22.0		**United States**	**14.1**	42	Virginia	8.7
10	Maine	21.5	26	Oklahoma	14.0	43	Vermont	8.5
11	Connecticut	21.3	27	Florida	13.8	44	Minnesota	8.2
12	California	21.2	28	Texas	13.8	45	South Dakota	5.5
13	Colorado	19.5	29	New Jersey	13.6	46	Wyoming	5.1
14	Rhode Island	17.5	30	Georgia	13.3	47	Idaho	3.7
15	North Carolina	17.2	31	North Dakota	13.2	48	Alaska	2.9
16	New Mexico	16.6	32	Illinois	12.8	49	Utah	0.1
17	Montana	16.2	33	Pennsylvania	12.2	50	Oregon	-0.8

For the past several years, federal grant policy has been more stable than in decades. The budget control legislation created an environment discouraging major expansion of most federal programs. Most programs have also avoided deep cuts. Stable funding has discouraged major changes in the factors used to allocate grants among states. The big money changes have been in AFDC and particularly Medicaid, where continuing current services has led to sharp increases in spending.

The percentage increases have been largest in states with low per capita federal aid and smallest in states -- like New York and Vermont -- that have relatively generous social programs and thus higher per capita federal matching funds. The prime reason for the differential growth is that mandates -- for example, covering intact families with AFDC and expanding Medicaid -- have the most impact on the states with the least generous programs.

The state rankings in per capita federal grants show large disparities in federal support of state and local programs. Alaska and Wyoming get more than twice the national average. Florida and Virginia get less than two-thirds of the average.

Per Capita Federal Grants To State and Local Government, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Wyoming	$1,299	18	Tennessee	$632	34	Missouri	$548
2	Alaska	1294	19	Arkansas	607	35	Nebraska	545
3	New York	954		**United States**	**599**	36	Georgia	536
4	Rhode Island	904	20	South Carolina	584	37	Iowa	528
5	Montana	850	21	New Jersey	582	38	Maryland	526
6	North Dakota	840	22	Oregon	580	39	Illinois	516
7	Massachusetts	785	23	Michigan	579	40	North Carolina	512
8	South Dakota	767	24	Minnesota	577	41	Colorado	506
9	Louisiana	764	25	Alabama	574	42	Indiana	493
10	Maine	749	26	Pennsylvania	574	43	New Hampshire	488
11	Connecticut	727	27	Ohio	569	44	Arizona	483
12	New Mexico	722	28	Delaware	568	45	Utah	474
13	Vermont	721	29	Idaho	568	46	Kansas	467
14	West Virginia	713	30	Wisconsin	565	47	Texas	452
15	Mississippi	703	31	Washington	564	48	Nevada	423
16	Kentucky	672	32	Oklahoma	563	49	Florida	392
17	Hawaii	651	33	California	556	50	Virginia	387

The formula for being high on this list *without* spending extra state money is to be (1) a resource-rich state with large federal landholdings resulting in shared revenues from exploitation of minerals, grazing areas, oil and gas, and timber, (2) a state with many federal installations and/or Indian reservations giving rise to impact aid for schools and other special payments, and/or (3) a less populous state benefiting from the per-state minimums in some federal programs. Having a large poor population and low fiscal capacity helps, but not enough to pull Southeastern states from the middle of the rankings. Federal grants for AFDC and Medicaid and some smaller programs respond to state decisions on eligibility and payment rates as well as state aggressiveness in qualifying spending for reimbursement. These factors account for the high rankings of New York, Rhode Island, and Massachusetts. States without substantial public lands and generous social programs are on the bottom of the rankings.

TECHNICAL NOTES

Property Tax Reliance: The growth of property tax reliance through FY 1990 can be calculated by state from Census data. The estimate for the first quarter of 1992 isn't broken down by state by its originator, the Bureau of Economic Analysis of the Commerce Department.

Health And Medicaid Costs: The Medicaid cost increase table should match increases in state cash outlays during the period of October 1990 to October 1991 because the federal match is a constant ratio to the state outlays. The increases will be close to FY 1991 state increases, but not the same because most state fiscal years are three months different from the federal one used in the table and there are slight changes in matching ratios affecting the lower per capita income states.

The quote from Representative Waxman is from his article in a symposium on intergovernmental health care issues in Intergovernmental Perspective (Spring). The quotes from the Tennessee debate are from the Tennessean (5/3), which also printed the Medicaid fiscal statistics from the Tennessee Medicaid Bureau that form the basis for the two charts on Tennessee Medicaid finance.

Many states force subsidy of provision of services to low income persons, parallel to Medicaid for health care, by methods not involving general fund taxes. This is done in rate orders for telephone, electric, and gas service through "lifeline rates." It is done in assigned risk plans in auto insurance, health insurance, and in a variety of regulatory attempts to get financial institutions to make investments in distressed areas. There are also levies on providers of services to fund indigent criminal defense, losses from breaches of trust by lawyers and other fiduciaries, and more. Considerable effort has gone into design of these plans so they do not appear to involve a *tax* or a *subsidy*. Tennessee's next shot at qualifying health provider levies is to reverse these presumptions by converting them into explicit taxes and subsidies parallel to explicit taxes and subsidies in Medicaid.

Packaged as part of an overall state policy for the indigent (e.g., telephone subsidies in telephone rates, indigent defense in lawyers' charges, hospital care for the indigent in hospital charges), it would be hard for federal officials to reject a new Tennessee plan. While it would take credit for what the state is already doing, it is not a subterfuge.

Measuring Development: The 1992 Development Report Card is published by the Corporation For Enterprise Development (777 North Capitol St., Washington, DC 20002). The persistent inability of either CfED or Grant Thornton to produce rankings that correlate closely with recent developmental successes won't surprise believers in the theory that business moves to places with low incomes and workers moves away from them will tend to equalize per capita incomes. See "Are Regional Per Capita Earnings Diverging?" in the Business Review (Federal Reserve Bank of Philadelphia, March/April).

Federal Grants: Federal grant spending is reported in the Census Bureau publication Federal Expenditures By State For Fiscal Year 1991.

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June 1992 (Second Of Two June Issues)

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THE INDEX OF STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The latest Index of State Economic Momentum shows continued uneven growth in state economies.

Index Of State Economic Momentum, June 1992

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	3.36%	18	Wisconsin	0.89%	34	West Virginia	-0.12%
2	Idaho	2.05	19	Alabama	0.77	35	Maine	-0.15
3	Washington	1.98	20	Tennessee	0.77	36	Nebraska	-0.17
4	Utah	1.84	21	Georgia	0.61	37	South Carolina	-0.17
5	Arkansas	1.64	22	Minnesota	0.61	38	Missouri	-0.22
6	Montana	1.49	23	North Dakota	0.51	39	California	-0.39
7	North Carolina	1.47	24	Indiana	0.50	40	Ohio	-0.48
8	Oregon	1.38	25	Louisiana	0.50	41	Oklahoma	-0.50
9	Hawaii	1.33	26	Arizona	0.49	42	Pennsylvania	-0.54
10	Colorado	1.19	27	Florida	0.48	43	Illinois	-0.61
11	Alaska	1.17	28	Kansas	0.45	44	Maryland	-0.86
12	Texas	1.17	29	Vermont	0.33	45	New Hampshire	-1.14
13	Kentucky	1.15	30	Iowa	0.09	46	Massachusetts	-1.16
14	South Dakota	1.13	31	Michigan	0.04	47	New Jersey	-1.20
15	Mississippi	1.09	32	Delaware	0.00	48	Rhode Island	-1.47
16	New Mexico	1.05		**United States**	**0.00**	49	New York	-1.49
17	Wyoming	1.02	33	Virginia	-0.08	50	Connecticut	-1.62

Western states dominate the top ranks of the states in this composite measure of economic performance. **Nevada** keeps its top ranking despite some economic slowing, primarily because of its strength in drawing retirees who create new jobs in housing construction, government, and service industries. Other top-ranked states have been outperforming the nation in job growth and thus in personal income growth and, sooner or later, in population growth.

The Index sets the national average at 0%, which reflects personal income growth of 2.8%, employment loss of 0.4% and a population gain of about 0.8%. A state matches this average by matching all three components, or by any combination of deviations from them that cancel each other. Most regions are represented among the average-performing states. They include previous high flyers like **Florida** as well as **Iowa**, **Delaware**, **Michigan**, and **Vermont**. Because the most populous states are showing below average performance, more than half the states are beating the national average.

Northeastern states dominate the bottom ranks as they have for the last several quarters. Important changes are taking place among the bottom ranks. First, **California** is sinking. It fell from 25th in December (Issue 24 of 1991) to 37th in March (Issue 6) to 39th in the current index. Second, most of the New England states are improving their performance relative to other states. In the last index, the bottom five ranks were all held by New England states, but now **New Jersey** (#47) and **New York** (#49) have moved into the bottom five. Third, the New England states are moving closer to the national average. For example, **Massachusetts** has moved from -2.4% in the last index to -1.2% in this one.

Employment Shows Slight Decline

From March of last year to this March, the nation's economy lost about 400,000 jobs, or about 0.37% of all jobs. The distribution of job gains and losses was highly skewed, with 32 states experiencing gains and 18 showing losses. **Texas** was the largest gainer (74,200) followed by **Indiana** (33,200), **Washington** (31,600), **North Carolina** (28,500), **Kentucky** (26,600), and **Arkansas** (25,200).

As has been the case for the past several quarters, the job gains are concentrated in states West of the Mississippi River. Of the top 17 states, only **Kentucky** and **Indiana** are East of that river. Of the bottom 17 states, only **California** and **Oklahoma** are West of the Mississippi.

Percentage Change In Employment, March 1991 To March 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	3.7%	18	Louisiana	1.3%	34	Virginia	-0.5%
2	Arkansas	2.7	19	Minnesota	1.1	35	Vermont	-0.6
3	Nevada	2.7	20	Texas	1.0	36	Florida	-0.6
4	South Dakota	2.6	21	Tennessee	1.0	37	Oklahoma	-0.7
5	Montana	2.5	22	Iowa	1.0	38	Illinois	-0.7
6	North Dakota	2.4	23	North Carolina	0.9	39	Ohio	-1.1
7	Utah	2.3	24	Wisconsin	0.9	40	Pennsylvania	-1.3
8	Kansas	2.3	25	New Mexico	0.8	41	South Carolina	-1.3
9	Kentucky	1.8	26	Alabama	0.7	42	California	-1.4
10	Alaska	1.8	27	West Virginia	0.3	43	New Hampshire	-1.7
11	Mississippi	1.6	28	Maine	0.3	44	Rhode Island	-1.7
12	Colorado	1.5	29	Arizona	0.2	45	Massachusetts	-1.9
13	Washington	1.5	30	Michigan	0.2	46	Delaware	-1.9
14	Wyoming	1.4	31	Georgia	0.1	47	Maryland	-2.5
15	Indiana	1.3	32	Nebraska	0.0	48	New Jersey	-2.6
16	Hawaii	1.3		**United States**	**-0.4**	49	New York	-2.7
17	Oregon	1.3	33	Missouri	-0.5	50	Connecticut	-3.0

Job losses were concentrated in **New York** (-214,400) and **California** (-179,900). These two states can be viewed as absorbing the total national job loss, with the other 48 states reflecting no net change in jobs. Of the other 48, the large job-losing states were **New Jersey** (-92,100), **Pennsylvania** (-63,800), **Massachusetts** (-53,100), **Ohio** (-52,700), and **Maryland** (-52,400). While New York and California lost the most jobs, they didn't have the worst percentage loss, an honor won by **Connecticut**.

Personal Income Growth Slow

Personal income in the fourth quarter of 1991 was 2.8% ahead of personal income one year earlier. This increase is exactly equal to the change in the Consumer Price Index between February of this year and a year earlier. So, adjusted for inflation, personal income didn't show any growth. The state-by-state statistics are shown in the table.

Percentage Change In Personal Income, Fourth Quarter 1990 To 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	North Carolina	5.7%	17	Oregon	4.2%	32	Pennsylvania	2.7%
1	Wyoming	5.7	17	Wisconsin	4.2	35	Missouri	2.6
3	Utah	5.4	20	South Dakota	4.1	36	Nebraska	2.5
4	Montana	5.3	21	Tennessee	4.0	36	Oklahoma	2.5
5	Arkansas	5.2	22	Delaware	3.9	38	Virginia	2.4
6	Washington	5.1	23	Georgia	3.9	39	Iowa	2.3
7	Mississippi	4.9	23	Vermont	3.9	40	New Jersey	2.2
7	Nevada	4.9	25	North Dakota	3.4	41	Kansas	2.1
9	New Mexico	4.8	26	Arizona	3.3	42	Maryland	2.0
10	Colorado	4.7	26	West Virginia	3.3	43	Illinois	1.9
10	Hawaii	4.7	28	Minnesota	3.1	44	Maine	1.8
12	Alabama	4.6	28	South Carolina	3.1	45	California	1.6
12	Kentucky	4.6	30	Indiana	3.0	45	Massachusetts	1.6
12	Texas	4.6	31	Florida	2.9	47	New York	1.3
15	Alaska	4.4		**United States**	**2.8**	48	Connecticut	1.2
16	Idaho	4.3	32	Michigan	2.7	49	New Hampshire	1.1
17	Louisiana	4.2	32	Ohio	2.7	50	Rhode Island	0.3

Small states generally did better than large ones, as indicated by the fact that 31 states beat the national average gain. As was the case for employment, Western states generally did better than Eastern states. But there are exceptions in the strong personal income growth in **North Carolina**, which tied for first, and in **Alabama**, **Kentucky**, and **Mississippi**. Personal income in **Rhode Island** actually declined in the third quarter from the previous third quarter, but the fourth quarter change was a slight increase of 0.3%. **California** joined most Northeastern states in the list of poor performing state economies.

The sources of personal income growth were bad news for state tax collectors. From 1990 to 1991, personal income grew by $154.6 billion, an increase of 3.3%. Of the increase, about $75 billion, or just about half, resulted from an increase in non-taxable or lightly taxed transfer payments like Social Security (up 8%), Unemployment Compensation payments (up 48%), employee pensions (up 7%), and AFDC payments (up 10%). Income taxed by states fared less well, with dividends and interest up only 0.1% and wages and salaries up only 2.5%.

Housing Activity Suggests Changing State Patterns

Housing, as measured by the issuance of permits to construct new homes and apartments, can serve as a significant leading indicator of state economic activity. The table suggests possible longer term trends among the states.

Percentage Change In Residential Building Permits, First Quarter, 1991 And 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Wyoming	129%	17	Rhode Island	51%	34	New York	29%
2	Montana	124	19	Missouri	49	35	Maine	28
3	Colorado	91	20	Tennessee	48	36	Georgia	26
4	Idaho	76	21	Arizona	47	37	Oregon	25
4	Iowa	76	21	Virginia	47	38	West Virginia	21
6	Illinois	75	23	Alabama	46	39	Nevada	19
6	New Jersey	75	23	Nebraska	46	40	Pennsylvania	16
8	Utah	69	25	Maryland	45	41	South Carolina	15
9	Kentucky	66	25	Michigan	45	42	New Mexico	14
10	Vermont	60	27	Mississippi	44	43	Florida	13
11	Louisiana	59	28	New Hampshire	42	44	Arkansas	7
12	Connecticut	58	28	Wisconsin	42	45	Delaware	6
12	Indiana	58	30	Massachusetts	41	46	South Dakota	4
12	Oklahoma	58	31	Texas	38	47	North Dakota	-4
15	Kansas	53	32	Ohio	33	48	California	-10
15	North Carolina	53	33	Washington	32	49	Alaska	-31
17	Minnesota	51		**United States**	**30**	50	Hawaii	-37

California's low rank (48th) and **Hawaii**'s rock bottom 50th suggest these formerly high-flying economies may be bringing more bad news for state governments. New housing permit growth was also below the national average in such fast-growing states as **Arkansas**, **Florida**, **Nevada**, and **Oregon**. Conversely, some of the New England states show better performance than the national average.

ECONOMIC PERFORMANCE AND FISCAL PROBLEMS

National economic performance in the period covered by the Economic Momentum Index (p. 2) has been so poor that outperforming other states and the national average is no guarantee that a state is avoiding fiscal problems.

Getting By In FY 1992

Practically all states have followed the same pattern in financial management during the current year (FY 1992). Budget shortfalls developed during the year as a result of spending overruns and revenue shortfalls. Those shortfalls were recognized early this year by lower revenue estimates and higher spending estimates. The top-ranked states haven't been immune from this process. Because expectations for economic performance were low to begin with, some low-ranked states like **Massachusetts** and **New Hampshire** have been reporting relatively good fiscal news.

Against estimates as revised, *but not against estimates on which FY 1992 budgets were based when enacted*, the FY 1992 fiscal situation isn't a disaster. It isn't good either. **Reports** was recently asked by a reporter to identify states in good fiscal shape in FY 1992 and could only come up with a few. They were ones that improved their fiscal circumstances by steep tax hikes, with **Pennsylvania** as the best example.

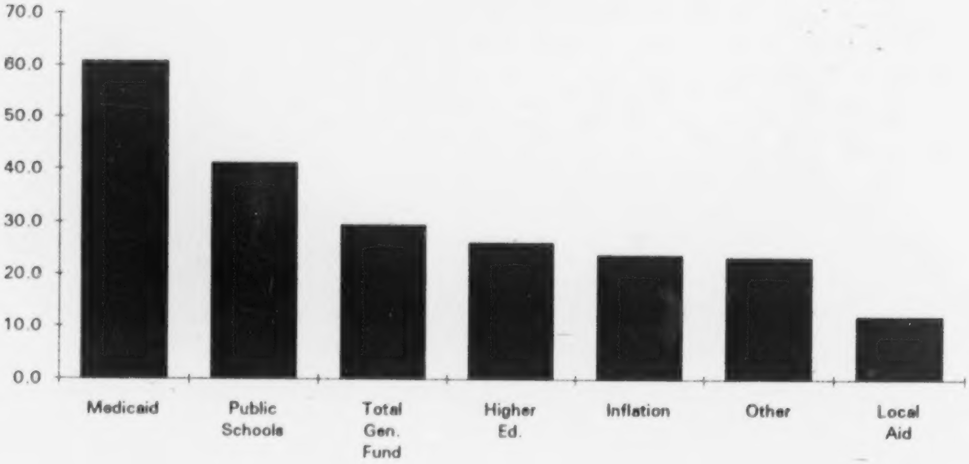
As documented in previous issues, most states have used two devices to deal with their FY 1992 fiscal problems. The first is moving the problems into FY 1993. The second is some type of revenue raising measure. These consist of a few substantial general tax increases (e.g., in **Kansas**, **Maryland**, **Mississippi**, and **Tennessee**) and aggressive use of Medicaid provider taxes in many states. Practically all states have been parsimonious with increasing spending for such functions as school aid, employee pay increases, welfare payment increases, and new initiatives. But layoffs and actual cutbacks of previous spending levels are rare.

Higher Education And Local Aid Taking Big Hits

Higher education and aid to local government are the two exceptions to the tendency to avoid significant cutbacks this year. In these two programs, the impact of state cuts can be muted by raising revenue, by sharp tuition increases, and by higher local taxes.

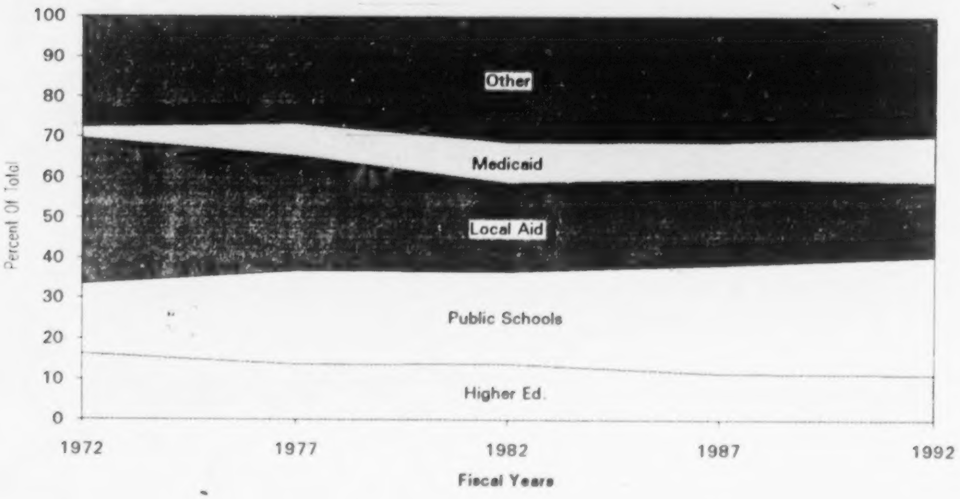
Wisconsin may not be indicative of every state, but probably is a good indicator of what is occurring in many states as decisionmakers adjust to tighter fiscal circumstances. The first chart on p. 7 shows how other programs have outdistanced spending increases for local aid and higher education.

Wisconsin Spending Growth
Percent Increase, FY 1987 - FY 1992



The graph below shows the changing shares of the general fund budget. While "Other" (top section) has remained constant, Medicaid and the schools have been increasing. Their gains have been losses for higher education and aid to local governments.

Changing Shares Of Wisconsin's General Fund



Economic Recovery Won't Solve All Problems

While the national economic news appears to be improving, don't expect good state fiscal news to follow. First, there is a residual of bad news in states that are lagging in the Index of State Economic Momentum. While some -- like **California**, **Illinois**, and **New Jersey** -- have announced large chunks of bad news, there may still be bad news to come in some of the others. Second, much of the bad news moved into FY 1993 is due to be discovered after the November elections.

Third, the use of one-time measures to balance FY 1993 has been so great that many states will be facing unusually difficult problems in balancing their FY 1994 budgets. This list includes the usual suspects, like **Michigan** and **New York.** Then there are states that have survived recession relatively nicely but used up their reserves and budget flexibility in the process: states like **Indiana** and **Minnesota**. Their ranks could be swelled by states where legislatures are reluctant to accept the budget-balancing measures being proposed by their governors this year, including **Massachusetts** and **Ohio**.

FEDERAL IMPACTS ON STATE DEVELOPMENT

The federal government currently is spending about $1.4 trillion a year, roughly 25% of gross domestic product. This much spending has colossal impacts on the distribution of economic activity, twice as large as either business investment or exports.

Chasing The Federal Dollar In New Places

State officials have long recognized this impact. They traditionally have been active in: (1) seeking new federal installations and trying to keep existing ones open, (2) encouraging grant policies and formulas benefiting their states, (3) encouraging other federal spending, such as agricultural subsidies and investments in water resource projects, that benefit their states, and (4) assisting state businesses in attempts to capture more of the federal procurement dollar.

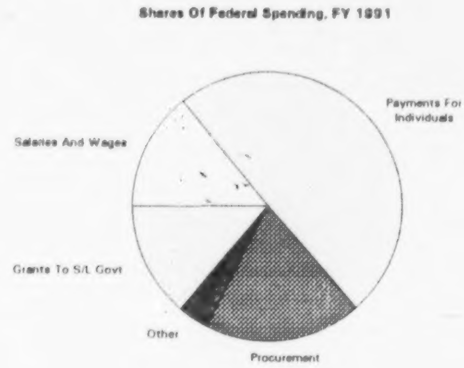
Success in these policies is becoming more difficult because of sharp changes taking place in the composition of federal outlays. While federal grant spending is rising rapidly (see Issue 11), most of the action is in Medicaid. There is little interest in modifying formulas for distribution of federal funds in other programs (see Technical Notes). Interest payments on the national debt are rising rapidly as the debt grows. But there is little states can do to maximize the portions of federal interest payments that go to their residents.

Besides grant money, state interest in the development impacts of federal policies has focused on federal procurement and the location of installations, and thus of employees receiving salaries and wages from the federal treasury. These (together known as "federal purchases" in national income accounts) have been declining. From the first quarter of 1991 to the first quarter of 1992, federal purchases dropped 2.2%.

Within this change, the federal government has been protecting its own payroll, which magnifies the reduction in federal procurement. Federal compensation rose 3.2% while purchases of goods and services declined by 6% for the year. If adjusted for inflation, this decline would be even greater. This results in competition among states as an exercise in trying to hold as much of the declining federal purchasing as possible, rather than competition for new investments that might stimulate state economies.

The Big Money (And Growth) Is In Retirement Payments

The major increases in federal spending, other than interest payments, is in the transfer payments made to individuals -- primarily Social Security but also federal employee retirement, veterans pensions, railroad employee retirement, and other smaller programs. These payments were 11% higher in the first quarter of 1992 than a year earlier.



Shares Of Federal Spending, FY 1991

The pie chart shows the distribution of federal spending for FY 1991 that can be associated with impacts on each state. It excludes interest on the national debt, foreign aid, and the small portion that federal officials can't trace by state.

The chart makes it clear that the big money is in payments to individuals, which is also the category that is growing most rapidly. Over the 1990s, its share will become even larger.

State Impacts Of Federal Payments For Individuals

The differences among states in per capita federal payments for individuals aren't dramatic. All states are within 20% of the average of the 50 states, excepting the three top and two bottom states. However, relatively small differences have enormous economic impacts because the amounts involved are so large. For example, **Florida**'s $579 per capita advantage means that the state gets $7.7 billion more in annual personal income as a result of its extraordinary concentration of these payments.

The table shows the per capita amounts of federal direct payments for individuals in FY 1991, which ended for the federal government on September 30, 1991.

Per Capita Federal Direct Payments For Individuals, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Florida	$2,707	18	Iowa	$2,189	34	Vermont	$1,991
2	West Virginia	2,680	19	Virginia	2,176	35	Hawaii	1,952
3	Pennsylvania	2,609	20	Kansas	2,175	36	Indiana	1,947
4	Rhode Island	2,538	21	Arizona	2,164	37	Louisiana	1,947
5	Arkansas	2,414	22	Connecticut	2,164	38	Nevada	1,942
6	Massachusetts	2,404	23	Ohio	2,162	39	New Hampshire	1,911
7	New Jersey	2,306	24	Kentucky	2,138	40	South Carolina	1,910
8	Maine	2,303	25	Illinois	2,130	41	North Carolina	1,902
9	Alabama	2,281		**50-State Average**	**2,128**	42	Idaho	1,892
10	New York	2,267	26	North Dakota	2,118	43	California	1,864
11	Missouri	2,266	27	South Dakota	2,111	44	Colorado	1,829
12	Oregon	2,235	28	Tennessee	2,101	45	Minnesota	1,829
13	Oklahoma	2,220	29	Nebraska	2,100	46	Texas	1,814
14	Maryland	2,218	30	Delaware	2,065	47	Wyoming	1,813
15	Mississippi	2,203	31	Washington	2,041	48	Georgia	1,810
16	Michigan	2,202	32	Wisconsin	2,038	49	Utah	1,537
17	Montana	2,194	33	New Mexico	2,007	50	Alaska	1,204

While these payments include other programs, the totals are dominated by Social Security and related Medicare payments. Without migration, the highest ranked states would be those with a high proportion of elderly population with earnings histories sufficient to quality them for relatively high Social Security retirement and disability pensions. This explains the high ranks of states like **Pennsylvania** and **Rhode Island** and the low ranks of Western states (low percentage of elderly) and Southeastern states (low wage histories). States not fitting this pattern, such as **Arkansas** and **Florida**, have drawn Social Security and federal retirement recipients through migration.

Changes In State Shares Of Federal Payments

The percentage changes in these payments (p. 11) show impressive gains in nearly every state when compared with gains in other federal spending, inflation, and the private sector of states' economies. **Nevada** leads by a wide margin because it combined: (1) substantial gains from migration of affluent retirees, and (2) the advantage of starting from a low base, in the bottom third in per capita amounts. **Florida**, starting first in the nation, cannot easily sustain the rapid growth rate that brought it to first. It is 19th in terms of change.

Percentage Change In Federal Payments For Individuals, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	14.6%	18	Oregon	9.6%	34	Illinois	8.4%
2	Alaska	12.1	19	Florida	9.3	35	Arkansas	8.3
3	Rhode Island	11.2	20	Utah	9.3	36	Wyoming	8.3
4	North Carolina	11.0	21	Kentucky	9.2	37	Pennsylvania	8.3
5	Maine	10.8	22	Virginia	9.2	38	Missouri	8.3
6	Delaware	10.6	23	Texas	9.1	39	Louisiana	8.0
7	Georgia	10.6	24	Idaho	9.0	40	Oklahoma	7.9
8	Vermont	10.1	25	Indiana	9.0	41	West Virginia	7.9
9	Connecticut	10.1	26	Hawaii	8.9	42	Montana	7.8
10	California	10.1		**United States**	**8.9**	43	Wisconsin	7.7
11	New Jersey	10.0	27	New Mexico	8.9	44	Minnesota	7.5
12	Arizona	9.9	28	New York	8.9	45	Iowa	7.3
13	Tennessee	9.9	29	Massachusetts	8.8	46	Kansas	7.2
14	Washington	9.8	30	Mississippi	8.7	47	South Dakota	7.1
15	Maryland	9.8	31	Colorado	8.6	48	Nebraska	6.3
16	South Carolina	9.7	32	Ohio	8.6	49	North Dakota	5.3
17	New Hampshire	9.7	33	Alabama	8.6	50	Michigan	4.8

The story in terms of fueling personal income growth and thus job growth is the bottom ten states. With their older populations, these Northern states are losing Social Security recipients about as rapidly as they are gaining new retirees. So their gains are little above the automatic escalation of Social Security payments resulting from: (1) inflation indexing of the pension amounts and (2) the increases that occur as persons with lower pension entitlements die and are replaced with new pensioners with somewhat higher pensions. The gains of the Northern states are cut because there is essentially no migration of retirees into them, while there is substantial out-migration of retirees.

Per Capita Gains From Federal Payments For Individuals

Yet another perspective is provided by looking at the one-year increase in per capita payments for individuals shown in the table on p. 12. These gains, like the percentage gains, are relatively small in some Northern states, particularly Michigan and the Dakotas.

Many of the biggest gainers are states like **Rhode Island** and **Maine**. They have stable total populations, but the average age is increasing. The other large gains occur in retirement destination states like **Nevada** and **Florida**.

Per Capita Increase In Federal Direct Payments For Individuals, FY 1990-FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Rhode Island	$256	18	Vermont	$183	34	Hawaii	$160
2	Nevada	248	19	Virginia	183	35	Montana	160
3	Florida	230	20	Washington	183	36	Idaho	157
4	Maine	225	21	Kentucky	181	37	Texas	151
5	New Jersey	209	22	Alabama	180	38	Iowa	148
6	Pennsylvania	200	23	Mississippi	177	39	Wisconsin	146
7	Connecticut	199		**50-State Average**	**175**	40	Kansas	145
8	Delaware	199	24	Georgia	174	41	Colorado	145
9	Maryland	198	25	Missouri	174	42	Louisiana	144
10	West Virginia	197	26	Ohio	171	43	South Dakota	141
11	Arizona	196	27	California	171	44	Wyoming	139
12	Oregon	195	28	South Carolina	170	45	Utah	131
13	Massachusetts	193	29	New Hampshire	169	46	Alaska	130
14	North Carolina	189	30	New Mexico	165	47	Minnesota	127
15	Tennessee	189	31	Illinois	165	48	Nebraska	125
16	Arkansas	186	32	Oklahoma	163	49	North Dakota	107
17	New York	185	33	Indiana	161	50	Michigan	102

Implications For State Policies

Recognizing The Value Of Retirees: For many reasons, retirees with Social Security pensions and Medicare coverage are valuable for economic development. First, they typically don't carry major government costs, particularly for states. They don't place demands on public schools or become eligible for AFDC payments. They place only minor demands on universities and the criminal justice system. With their Medicare coverage, they don't add to indigent health care costs and can't make demands on Medicaid (unless they go into nursing homes and exhaust their assets).

Second, they don't take jobs, but the money they bring creates substantial job opportunities for a large segment of new workers in the states in which they reside. This is particularly true in health care, but also in other service and maintenance positions and in retailing.

Because the amounts at stake are greater than with more obvious federal impacts, such as defense purchasing, states exhibit substantial interest in keeping retirees in the states where they worked as well as attracting them by migration. This interest is bound to grow with declining federal purchases and the rapid growth in Social Security and federal retirement payments.

Tax Concessions For Retirees: The conflicting pressures on state policy are most obvious in decisions on taxation of property transfers at death. On tax policy grounds, there are strong arguments for steep death (inheritance and estate) taxes. The estate clearly has the ability to pay and the tax obviously cannot reduce work incentives for the taxpayer, who is by definition deceased. In general, beneficiaries of rich dead people are rich live people, with exceptions to taxes easily crafted when beneficiaries are charities and poor people. Confronted with major differences among states in death taxes, older affluent persons can simply change their state of residence and avoid the higher taxes.

Concern with competition seems to be prevailing. There has been a movement among states to cut back estate and inheritance taxes to the federal pick up tax level. Taxes at that level simply reduce federal taxes dollar for dollar by the amount of the state tax, so every state levies them -- though **Nevada** hopped on this bandwagon only a few years ago. Reducing higher taxes has been an issue in states like **Massachusetts**, **Minnesota**, and **New York**. For example, the **Massachusetts** House recently voted nearly unanimously to increase the current exemption from $200,000 to $350,000, moving the state closer to the policies of other states.

Many states deviate from federal tax law by permitting Social Security payments to be excluded from taxable income. This policy generally was adopted without a strong emphasis on economic development impacts. Instead, it is part of a group of tax policies -- including homestead exemptions and the residuals of double exemptions for age in income tax laws -- that reflect a widespread perception that elderly persons are, as a class, poorer than non-elderly. They also reflect the concept that policies benefiting all elderly persons, rather than means-tested programs, are appropriate responses to poverty among the elderly.

BREAKFAST AT SCHOOL, IT'S COOL

The title of this article is the slogan of **Pennsylvania**'s version of a campaign encouraging breakfasts at school. The logic of the program is, as Governor Casey puts it, "You can't teach a hungry child." There is a strong correlation between eating breakfast and pupil achievement, though it isn't clear whether the breakfasts cause the achievement or some other factor(s) encourages both achievement and the morning meal.

In a year of tight budgets, expanding breakfast at school is one of the few initiatives attracting elected officials. Casey's budget reflects a 16% increase in state funding. Governor Finney signed legislation mandating increased participation by **Kansas** schools. **Missouri**'s new legislation mandates school district participation, but permits opting out by a school board vote. It is a compromise between some legislators, who wanted mandates, and school administrators who said they opposed mandates, not breakfasts.

The participation of low income children in school breakfast programs is highest in the low per capita income states of the Southeast, but **Idaho** and **Utah** combine low per capita income with low participation rates as shown in the table.

Percent Of Low-Income Students Getting School Breakfasts

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	56.6%	18	Florida*	33.6%	34	Indiana	18.1%
2	Tennessee	45.4	19	California*	32.9	35	New Jersey	17.6
3	Kentucky	44.7	20	Alabama	32.3	36	Pennsylvania*	17.6
4	North Carolina	44.3	21	Maryland*	31.8	37	Iowa*	17.4
5	Mississippi	43.9		**United States**	**31.5**	38	Minnesota	17.2
6	Texas	43.7	22	New Mexico	30.5	39	Montana	16.1
7	Arkansas	41.2	23	Washington	29.4	40	Nebraska	15.8
8	Oklahoma	39.3	24	New York*	29.2	41	Vermont	15.7
9	Virginia	39.3	25	Ohio	28.0	42	Oregon	14.5
10	Massachusetts*	38.5	26	Missouri	27.8	43	North Dakota	13.5
11	Delaware	37.4	27	Alaska	24.0	44	New Hampshire	13.3
12	Arizona*	37.2	28	Connecticut*	23.6	45	Idaho	12.9
13	South Carolina	36.5	29	South Dakota	23.5	46	Wisconsin	12.5
14	Georgia	36.0	30	Maine	22.6	47	Michigan	12.0
15	Hawaii	35.6	31	Illinois	20.1	48	Wyoming	11.5
16	Louisiana	35.3	32	Colorado	19.5	49	Kansas	10.8
17	Nevada	35.1	33	Rhode Island	19.3	50	Utah	6.7

The school breakfast program is a federally funded extension of the school lunch program. All states have an administrative role. About a third mandate participation by some schools, generally those with high concentrations of low-income students. The nine states indicated (*) on the table, among the most affluent ones, supplement the federal subsidies.

Differing state policies promoting breakfasts are probably the most significant factor explaining differing participation rates and changes in participation. From 1990 to 1991, participation rose 9.7% nationwide. **Washington** increased participation by 76%, followed by **Vermont** (47%), **Idaho** (40%), **Nebraska** (33%), **Connecticut** (32%), **Maine** (31%), and **Minnesota** (29%). Participation dropped 25% in **Indiana**, 10% in **Wisconsin**, and 2% in **Hawaii**.

WHAT IS A "FAIR RETURN?"

The concept of an appropriate *rate of return on investment*, or *cost of capital* is often garbled in public understanding and sometimes in legislation. The concept is well settled in some state policies, such as public utility regulation and tax administration. But it is a major source of dispute in dealing with health care providers and auto insurance companies.

Recognizing "Profit" As A Reasonable Cost

In some sense, "profit" is bad. For example, no one should profit from the misfortunes of others, thus all drug company "profits" are bad. In this sense, "profit" has no place in treating the sick, so there is something suspect about for-profit companies managing hospitals, but not-for-profit and county hospitals don't present these problems.

But on reflection, practically everyone recognizes that if investors can earn interest on loan investments, they will have to be given some reward if they are to make equity investments. That return looks more acceptable if packaged as "return on investment" or "rate of return" rather than profit. This is done in major programs in which government attempts to make payments based on "cost." As a result, the reimbursements allowed not-for-profit defense contractors, such as universities and research institutes, closely resemble those of for-profit defense contractors. State reimbursements under Medicaid for nursing homes and hospitals do not differ based upon the organizational form of the provider.

Under the U.S. Constitution, governments cannot take property without just compensation. To take land for a highway, for example, states must go through condemnation proceedings and pay just compensation. That compensation is basically market value, which depends upon the profits or returns that owners can get from using the property. But suppose that instead of taking the land, states do something that reduces the potential profits from the land? In extreme cases, this is also a "taking." For example, a new highway could cut off a corner of a farm and make access by farm equipment impossible. Zoning regulations, prohibitions against rebuilding beach properties, and limits on "noxious" uses such as having farm animals in urban areas are closer cases.

These cases arise frequently in public utility regulation, where the basic standard is that those who have invested in telephone and electric facilities must have a reasonable return on their investment. This doctrine has caused difficulties for state insurance reform measures, like California's Proposition 103. The California voters adopted a rate rollback that would have left some companies with no returns. The state's highest court ordered that the proposition be interpreted in a constitutional fashion, barring rate reductions except those based upon a finding that returns to insurance companies were unreasonably high.

State Definitions Of Reasonable Return

Some of the benchmarks for rates of return are shown in the table below.

Some Benchmarks for Rates Of Return on Equity Capital

Benchmark Basis	Annual Return Rate
Unregulated Private Companies, Last Ten Year Average	
Fortune Top 100	14.3%
General Motors	8.5
Exxon	19.1
IBM	7.2
State-Regulated Utilities, 1991	
Entergy	11.6
General Public Utilities	12.0
Gulf States Utilities	2.0
NICOR	15.2
GTE Corp. (telephone operations)	15.0
Dominion Resources	12.4
State Regulated Utilities, Average 1977-1991	
Before Disallowance Of Imprudent Investments	12.7
After Disallowances Of Imprudent Investments	11.7
Allowed Returns In Recent Rate Cases, Company (State)	
Bangor Hydro-Electric Co. (Maine)	12.2
Wisconsin Public Service Corp. (Wisconsin)	12.8
Dayton Power & Light Co. (Ohio)	13.0
Atlanta Gas Light Co. (Georgia)	12.0
Long Island Lighting Co. (New York)	11.6
Central Telephone Co. (Nevada)	12.0
Southern California Edison Co. (California)	12.6

The table shows the narrow range of what state utility commissions consider to be a reasonable return on equity capital, with the recent rate cases in the range of 12-13%. Actual returns of regulated utilities average about this level, but there is substantial deviation among individual companies. Disallowance of investment in nuclear facilities is the primary reason for the low returns exhibited by several of the companies in the table. Industrial returns are higher than regulated utility returns, reflecting regulators' conclusions that lower risks in utility operations merit lower returns.

Many states (and the federal government) also apply market tests of returns on capital -- debt as well as equity -- in selecting rates of interest for money owed by and to taxpayers for underpayments and overpayments. For example, **California**'s Franchise Tax Board set a rate of 10% for the first half of 1992. **New York**'s tax agency set a rate of 8% for the second quarter of 1992 for alcoholic beverage and cigarette taxes. **Iowa** is charging 11% while **New Jersey** is using 11.5% in 1992. **South Carolina**, which bases its rate on the federal one, is charging 8%, but also paying 8% on overpayments.

INDIGENT HEALTH COSTS, NEW JERSEY

There has been a rush of activity in many states to convert indigent health care costs to Medicaid financing wherever possible, as reported in detail in prior issues of **Reports**. The concept is being applied, for example, to the general assistance medical program in **Ohio.** It is proposed for **Arizona**'s state-funded health system and **Pennsylvania**'s lottery-funded prescription program for the elderly.

Not all states have followed this pattern. **New Jersey** is one that hasn't. Instead, New Jersey funds indigent hospital care through the Uncompensated Care Trust Fund. The Fund gets its money, about $900 million a year, from a "surcharge" on hospital bills which is now 19%. This surcharge has no advocates. Many New Jersey leaders, including organized business and labor, expected to replace it with an elaborate "play or pay" comprehensive health care plan. Small business and legislators balked at the steep costs to be imposed on employers, so the plan failed. So with great reluctance, but general acquiescence, the legislature has extended the Trust Fund periodically while looking for a long term solution.

The legal reason that state proposals for universal health care take the form of "play or pay" is that states need a legal hook for jurisdiction over employee benefit plans. The federal Employee Retirement Income Security Act (ERISA), which was designed primarily to regulate private pension plan funding, has been interpreted as preempting state control over employee benefit plan provisions and administration.

States can clearly regulate health insurance, but an increasing number of plans avoid this regulation. The most common avoidance is through "self-insurance," by which employers, not insurance companies, provide the benefits. Another variation is for unions to provide the health coverage, with employers contributing to the union-run plans. So the state proposals for universal care are built around the taxing power. They levy a payroll tax on employers ("pay") but provide a tax exemption for employers who provide health insurance for their own employees ("play").

Because "play or pay" wasn't enacted, New Jersey has been making private pay patients, union plans, and employer self-insurance pay the surcharge without the legal hooks of either taxing power or power to regulate insurance. The union plans sued in federal court claiming that ERISA precluded the state from imposing its 19% surcharge. They won in late May in federal district court. The order could be appealed, but New Jersey officials may not press the case if a legislative solution can be found. The governor commented that the attorney general had no choice but to defend the law, but "it is a law that must be changed."

While not explicitly covering self-insurance, the decision's logic would clearly apply to self-insurance as well. It doesn't apply to purchased insurance, but the state AFL-CIO (and probably other labor and employer organizations) have been looking for ways to take existing plans out of the insurance mode, and thus out of state regulation. Recognizing the pressure that the union action has put on state officials, the head of the New Jersey AFL-CIO commented, "The issue can no longer be ignored."

GOVERNING ARIZONA

Arizona's problems are so unique that they may not have any national significance. The state was the most recent to impeach a governor and the only one that couldn't resolve who would be the governor without a special election. That governor (R) has serious legal problems from past involvements in the savings and loan industry and lower approval ratings than the low approval ratings being logged by other governors. Twenty legislators have already indicated they are not running again, up from a previous record of 18 set in 1972.

The governor's theme of bringing business management to government led to a business-oriented task force to deal with issues like improved management, better organization, and cost cutting. This standard approach for newly-elected governors, particularly Republicans, has produced some non-standard results. Project SLIM (State Long-Term Improved Management) is itself expensive -- a $1.5 million contract with Coopers & Lybrand for consulting help and a $4.5 million appropriation request for FY 1993. Most such exercises rely on loaned business and/or state executives and small budgets, often contributed by business. Exceptions, like a recent **Connecticut** effort, spend more but only for one-time consultant reports on specific topics.

A prominent utility executive resigned his post as chairman of the steering committee. Another key member soon followed. Legislators, particularly in the Senate (D-led), may not fund Project SLIM, at least not at the levels the governor wants.

The legislature has problems of its own including gigantic ideological gulfs between its extreme members, well-publicized corruption, *and* all the other election-year problems associated with divided partisan control in a year of tight finances. More than average effort is devoted to debating reversals of past decisions, such as a mandatory insurance law and a "Drano tax." Two redistricting plans have been adopted. The legislature is suing the governor over veto power issues. Proposed tax cuts are being seriously discussed more or less independently of spending plans.

Newspaper editorials may not be a good place to get impressions, but the Arizona Republic's comments on April 19 merit some attention:

> *Would it be asking too much for the Arizona Legislature, which since early January has been simultaneously procrastinating on essentials and squabbling about trifles -- would it be asking too much for this garrulous assembly to get on with the real business of the state, adopt a budget and get out of town?*
>
> *Its lackadaisical work habits last year led to a 160-day regular session -- a record -- and four special sessions. This year's Legislature already has established a record for special sessions -- it is working on its eighth -- and easily could exceed last year's 160-day marathon. This is an inexcusable waste of time and money.*

RECORD PAY IN NEW YORK

New York's new health commissioner was originally to have been paid $160,000 a year, which **Reports** believes would have been the nation's highest pay for state cabinet officer. New York's governor makes $130,000. Some unusual situations permit higher pay than the governor: (1) doctors and psychiatrists working with patients in state institutions, (not working as administrators), (2) college professors with lucrative consulting sidelines, and (3) a few coaches at state universities.

The commissioner's pay was to consist of $98,000 salary and $62,000 for serving as president of Health Research Inc. The corporation is, in effect, an arm of the agency. Since 1953 it has been used to receive and disburse grants. The last New York commissioner also served as the corporate president, but received no extra compensation. The members of the corporation board are employees of the department. The corporation closely resembles the foundations run by many state universities. These are a constant source of controversy over supplementing salaries, whether they are subject to audit, and whether their funds must go through the appropriations process.

Some states permit private corporations in effect to supplement the pay of state executives. This would occur, for example, if a lawyer retained a partnership interest in a law firm, or a doctor received continuing compensation from a hospital with which he was affiliated. Such private supplementation is illegal in federal positions and in some states.

States generally permit employees to "moonlight" without restriction, so long as there is no hint of conflict of interest or double-dipping with their state job. For example, a state horticulturist could take a second job as a security guard or publish books on sports without restriction. There are controversial federal restrictions which states are not copying. The second income becomes more of an issue when an argument can be made that a state employee is being paid twice for the same job. This is the issue when Members of Congress accept payment for giving speeches.

Nine months of Senate inaction on the New York health commissioner nomination led in May to the nominee's agreement to forgo the extra compensation The legislature is expected to confirm the appointment and pass legislation providing for more oversight of operations like Health Research, Inc.

This is the season in which some leading state figures are releasing tax returns, which shed light on several practices. Governor Cuomo reported $124,200 in compensation for eight speeches, an average of over $15,000 a speech, mixed with uncountable numbers of appearances for which he did not charge. He gets a salary of $130,000, but takes a charitable deduction of $30,000 for turning part of it back to the state.

Governor Clinton is paid a stated salary of $35,000, but also has access to a "public relations fund" with little restriction on its use. If such money is used for personal purposes, it is taxable. The Clintons reportedly counted $19,000 from that source as CY 1990 income but had no comparable income in CY 1991. The Arkansas governor earned only $5,500 in honoraria in 1991.

Historically, some local officials in England were paid by fees. These "fee office" traditions have been eliminated throughout most of the United States, but a few examples persist.

In **Mississippi**, circuit and chancery clerks, who are elected officials, keep the fees they collect for issuing licenses and maintaining records. They pay their expenses, which they determine, from the fee income and keep the rest. Legislation is being considered to limit the take-home pay of these officials to compensation equal to the governor's, currently $75,800. Over a dozen of these officials would take a pay cut if the legislation passes.

EDUCATION REFORM IN MISSISSIPPI

How little has been happening on the 1980s education reform agenda (see Issue 10) was underlined by the reforms that passed with the Mississippi legislature's override of the sales tax increase bill. The only mandatory reforms are management items not inherently requiring significantly higher spending: (1) a mandated five-year plan for community involvement, (2) a requirement for public hearings on school budgets, and (3) an annual report card on local school performance, including test scores, from the state education agency. All other reforms are optional with the state board or local districts. This list includes: (1) relaxing accreditation standards (including past class size maximums and school day length minimums) to encourage innovation, (2) pilot use of summer semesters for remedial work, (3) experiments with gradeless schools, and (4) summer kindergarten.

MISCELLANY

State Directories

If the number of publications aimed at state and local officials with a glossy format and slick advertising is an indicator, there is increasing recognition of state impacts on businesses, both as a customer and a regulator. In the past decade, two standbys published by organizations of state officials (NCSL's State Legislatures and CSG's State Government) have been joined by City & State (Crain Communications) and Governing (Congressional Quarterly). The latest entry is to be Intellectual Ammunition For State Legislators to begin monthly publication in July. In its promotional literature, its publisher, The Heartland Institute (634 S. Wabash Ave., Chicago, IL 60605), criticizes Governing and State Legislatures as having a "liberal bias," producing "articles calling for higher taxes, greater regulation, and higher government spending."

The electronic age has improved the availability of directories of state officials. The Council of State Governments is the closest thing to an official collector of information with hard copy biennial publications: the Book Of The States, State Officials Classified By Function, 1991-92, and State Legislative Leadership, Committees, & Staff, 1991-92. NCSL maintains up-to-date information on individual legislators as well as staffs in forms that can be accessed selectively and electronically, in hard copy, and as printed labels. Thus NCSL is always the place to start asking about legislative branch directories. NGA has similar information on the much smaller universe of governors and immediate staffs. Associations of state agency directors like the American Association of State Highway and Transportation Officials and Federation of Tax Administrators keep current lists of their members, often cross-classified by functions within agencies. Some are sold. Most aren't, but are available for some purposes (e.g., research, but not selling insurance).

Commercial directory publishers maintain lists of state officials with excellent capabilities for electronic retrieval. The most active appears to be the Monitor Publishing Company (104 Fifth Ave., New York, NY 10011). It publishes the State Yellow Book four times a year with over 1000 pages of names, titles, addresses, and phone numbers. There are also private publishers in individual states. For example, the California Journal (1714 Capitol Ave., Sacramento, CA 95814) publishes the California Political Almanac and has also ventured into the national market with the 50-State Legislative Directory.

There is so much information in individual state capitols that Government Research Service (701 Jackson, Topeka, KS 66603) makes a business of tracking it. It gives away (800-346-6898) a directory, State Bill Drafting Manuals, to provide a basis for sending brochures on its other publications. They include the periodical Government & Politics Alert, (about information sources), a legislative telephone hotline directory, State Legislative Sourcebook (information for each state on contact points, newsletters, blue books, and more), and State Reference Publications (a state-by-state listing of statistical sources, biographies of legislators, and much more). It also has a nine-page appendix on national sources (which describes **State Policy Reports** as "excellent quality").

Secession And Dividing States

Dividing nations has become a hot world topic. Examples are the USSR, Yugoslavia, and serious discussion of independence for Scotland and Quebec. Secession hasn't drawn any interest in the U.S. since the 1980s when **Alaska** voters approved a statehood commission to reexamine whether becoming a state was a good idea. Historically, a few American states split from other states, as **Maine** did from **Massachusetts**. The last example was the division of **West Virginia** from **Virginia** when the old Commonwealth of Virginia couldn't agree on which side to take in the Civil War.

The latest move is to split Northern **California** from the rest of the Golden State. The movement, spurred by a member of the California Assembly, is being seized by county officials to emphasize their discontent. The area from San Francisco north to the Oregon border is generally rural, strong in natural resources but little else. Local economies are under pressure from federal and state environmental restrictions and from state-local fiscal relationship changes that seem to work better for Southern than Northern California. Advisory referendums supporting secession were approved in June in 27 counties.

The parallel move in the 1980s was to split **Michigan**'s Upper Peninsula away from the Lower Peninsula. The move received some study, but never serious consideration. The purpose was to dramatize alleged neglect by state government. The same thought is behind T-shirts appearing in Southwest **Kansas**. They show a tornado lifting the geographic area out of Kansas and say, "Toto, We're Not In Kansas Anymore!"

They were a protest against school equalization plans being considered in the legislature. The plans, now approved, involve a minimum property levy, reduced school aid to affluent districts, and higher state taxes. The net effect on districts in the Southwest with a high per pupil tax base could be both higher property taxes and less state aid. Voters in seven Kansas counties supported a new state in non-binding referendums in the April primary. Over 100 advocates, mostly county commissioners, have met to discuss concepts. One plan involves getting a total of 29 counties to join the movement, which would mean 220,000 people in 29% of the state's land area would secede.

Turnpikes And Independent State Authorities

The governors of **Massachusetts** and **New York** are eyeing resources from their **turnpike authorities** for non-turnpike purposes. In **Massachusetts**, the turnpike is being criticized as a fiefdom with little responsiveness to political control, though this criticism is primarily heard from the new administration (R) rather than legislative leaders (D). The governor is interested in selling the toll facilities. A recent study indicates they are worth about a billion dollars.

New York's governor wants to give the Thruway Authority control over the canal system and power to fund local projects such as waterfront development in Buffalo and Syracuse. Similar expansions of authority have already taken place with the Port Authority of New York and New Jersey. The Thruway debt is scheduled to be paid off in 1996 and the tolls eliminated. The new plan would extend the tolls. Critics say the plan is an attempt to revive the governor's "New, New York" plan to stimulate the state's economy -- an attempt to borrow without appearing to create new debt for the state itself.

Also Noted

The state programs to stimulate the economy announced early this year haven't turned into much. **Maine** legislators opted not to put major bond issues on the ballot. The issues approved by **California** voters in June were for routine school and university construction, with proposals for transit, housing, water, and waste disposal not making the cut. Action in **New Jersey** consists primarily of lifting a limit on spending from previously approved bonds. The U.S. Secretary of Transportation is still complaining that many states aren't moving fast enough to obligate federal highway funds.

An example of why **Reports** (Issue 9) dismissed City & State rankings of state fiscal stability as "junk ratings" is the complaint from **Oklahoma**'s comptroller that the publication used 76% as the gap between estimated and actual revenue rather than the 3% experienced. He complains that he can't recalculate the ratings to show what effect the correction would have on the state's ranking.

To its credit, C&S published the complaint (5/4) as well as publishing (6/1) a letter from Steven Gold (Center for the Study of the States) objecting to ranking **Tennessee** #1, criticizing the ratings, and concluding, "It would be better not to do it at all than publish such a misleading analysis." **Iowa**'s criticism, which wasn't published, is that it is being judged by GAAP standards while other states aren't.

TECHNICAL NOTES

Index Of Economic Momentum: The index, published quarterly, is the average of the differences between each state's latest one-year change and the national change in (1) population, (2) personal income, and (3) employment. The measure shows how each state's economy is performing in relation to the nation and other 49 states. Employment data are from the Bureau of Labor Statistics. Personal income and population data come from the Department of Commerce.

Fiscal Problems: It is difficult to assess changes in state spending for local aid because some aid takes the form of lower revenues (e.g., credits for local taxes paid) and some is off-budget (e.g., forms of shared revenues). Wisconsin was chosen as an example because the Wisconsin Taxpayers Association prepared material that incorporates some of the hard-to-measure changes.

Federal Impacts: The national statistics were calculated from the national income accounts in the Survey Of Current Business (April). The state-by-state and summary federal FY 1991 data are from the Census Bureau's Federal Expenditures By State For Fiscal Year 1991. Many formulas for allocating federal funds are hard to defend on any basis other than the political difficulties in making changes without a sweetener of more federal funding. For example, the Maternal and Child Health Services Block Grant funding is 90% controlled by factors in effect when 10 categorical programs were consolidated in 1981. A recent General Accounting Office report (Maternal And Child Health: Block Grant Funds Should Be Distributed More Equitably) finds that 60% of the differences in state allocations "are unrelated to either the number of beneficiaries or taxpayers' ability to pay."

School Breakfasts: The data on breakfast program participation comes from the Food Research & Action Center (1875 Connecticut Ave., NW, Washington, DC 20009). This foundation-funded group is a good source of information on hunger, including 50-state statistics.

Fair Returns: The industrial returns are from Fortune (4/20) and the utilities' from company annual reports." The 1977-1991 averages are from Public Utilities Fortnightly (4/15) and the allowed returns from the March and April issues of Fortnightly.

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Fiscal pressures have drawn attention to the many reports suggesting how to cut state budgets. But the attention hasn't kept state and local payrolls from growing faster than private ones in 47 states.

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Local officials claim, with justification, that state and federal actions are raising costs by mandates while cutting revenues from grants.

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State officials are refusing to abandon efforts to bring affordable health care to the uninsured. The effort isn't going well.

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Increasing talk of federal budget cuts raises questions of how much state economies will be affected. Part of the concern is with federal payrolls and contracts. Some states rely on them much more than others.

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Miscellany covers new higher education finance litigation, licensing professionals, water supply, and more.

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July 1992 (First Of Two July Issues)

INDECISION IN STATE FINANCES

Few Decisions At Decision Time

"Budgeting has become a year-around process." -- This is a common complaint in many states from legislators tired of prolonged regular legislative sessions. It is also a complaint of budget staffs reminiscing about days when the budget decision crunch came shortly before the beginning of the new fiscal year, followed by months of relative calm.

It is hard to measure whether more and more budget decisions have been shifted away from normal schedules for making them. Certainly, this has been true in **Texas**, where court decisions on school finance have kept the state's major spending category in a state of constant flux. It was true in FY 1992, when revenue shortfalls required most states to revisit their budgets for administrative cuts, special legislative actions, or both. But it may not prove to be a permanent change in state budget procedures, as distinct from a response to the special circumstance of shortfalls occurring after budgets have been set.

Another factor, elections, is at work in 1992. The budget decisions so far this year have been characterized by an extraordinary resistance to make decisions that would balance state budgets over the long term. That is, a reluctance to raise taxes and a reluctance to make major cuts in spending patterns. Instead, in most states, the choices have been deferrals of spending, acceleration of revenues, and simply finding ways to ignore imbalance until after elections.

In some states, the result has been an inability to reach any decisions quickly when confronted by major unacceptable alternatives. The best examples are **California** and **Florida**. In others, such as **Texas**, major decisions like revising the method of financing schools are being held until after elections. In yet others, the delay in decisionmaking isn't obvious. Instead, the decisions made in states like **New York** appear final, but may not hold up for the entire fiscal year. As a result, this year at least, many important state fiscal decisions will be made during the fiscal year. There will probably be some special sessions on finances in December and many states will make major budget revisions early next year. There will likely be some tax increases involved.

One example will probably be **Ohio**. The governor urged "sin tax" increases which the speaker rejected as being targeted at the poor. The governor rejected the speaker's plan to target the rich with income tax increases on those earning $200,000 or more calling it "a smoke screen." The result is no tax increase to finance FY 1993 spending. But the speaker commented in late June:

> *I think we should wait until sometime around December or January. We should look at the whole tax structure. I never have, and would not, run from my responsibilities to have a balanced budget.*

Budget Cutting In New Jersey

New Jersey, which held its legislative elections in 1991, is not on the same election cycle as other states. Its new veto-proof Republican majority hasn't so far shown the reluctance to make major fiscal decisions that has appeared in many other states. The majority repealed the one-cent sales tax increase that was part of the unpopular tax package of 1990 and turned attention to balancing the new budget.

That budget was hard to balance with the tax cut because the Garden State was one of the states most seriously affected by the recession. To propose a budget of $15.7 billion, the governor used many of the devices for balancing budgets without either raising taxes or cutting spending, including major revisions in retirement contributions.

The Republican's plan trimmed the total to $14.6 billion. The impacts were disputed. Sponsors predicted it would produce 1,500-2,000 layoffs in addition to the loss of about 2,500 jobs from attrition contemplated in the governor's budget. Florio Administration officials predicted even greater job losses from the plan. The Department of Human Services would lose about $190 million of the $3.7 billion budget request, with cuts concentrated in general assistance. The largest cut, $385 million, was in the $685 million homestead rebate program. The state transit agency would lose $35 million.

The treasurer said the plan was $226 million out of balance. Republican leaders replied if the governor really believed that, it was his duty to use vetoes to bring it into balance. Democrats and interest groups, frustrated by lack of hearings on the cuts, held a rump committee session to publicize cuts in higher education, general assistance, and state operating programs. Department heads warned of closed state parks, uncleared snow on highways, and loss of federal matching money. The debate as the budget passed the Senate on a party-line vote was spirited. An opponent lamented, "I don sackcloth and cover myself with ashes and tearfully cast my vote against this budget." A proponent hoped it was "only the beginning of tax cuts" and that there would be more cuts next year.

Avoiding Tough Decisions, Mental Health

Despite talk of layoffs and shrinking payrolls that constantly gains headlines in many states, there have been few savings in the labor-intensive operations of state residential institutions for prisoners and mental health patients. The barriers to corrections savings are rising prisoner counts and state officials often willing to pay the costs to back stiff sentencing and avoid crimes by prisoners in alternative corrections programs.

These explanations don't apply to mental health. The situation in **Ohio** is indicative of that in most states. Advances in pharmacology and changes in treatment doctrines have cut admissions to state facilities from a peak of 22,000 in 1971 to 11,800 in 1990. During the same period, the resident population dropped from 28,500 to 3,100. But the reduction hasn't been fully reflected in institutional closings. Instead, Ohio is operating five hospitals at 40% or less of capacity and one at 18%. Not surprisingly the ratio of staff to patients has grown in the past 20 years from 0.5 staff to one patient to 1.8 staff per patient.

State officials have shied away from the obvious alternative of institutional closings for reasons similar to Congressional reluctance to close defense installations. The facilities are often the major employers in otherwise depressed areas. A high percentage of workers could not find other employment locally. Institutional closings or scale-backs such as closing hospital wings have been pushed by some governors (e.g., in **Massachusetts** and **Virginia**) but have often become mired in controversy.

Privatization, More Talk Than Action

Many **Reports** readers and speech audiences, particularly business groups, are consistently interested in the extent to which state fiscal problems are causing moves to "privatize" the provision of state services. At least this year, the answer appears to be little, if any, depending on how "privatization" is defined. While the issue generates massive quantities of books and studies (see Technical Notes), the pace of policy change is slow.

The most obvious areas for privatization of state services are those where: (1) private provision of the services is common in the American economy and (2) some states already use the private sector. This view was taken by the business-oriented group in New Jersey (see related article) which declined to include privatization savings in its cost-cutting recommendations. Instead, it commented, "Priority consideration for potential privatization should be given ... to activities now conducted directly by the state government for which there are currently private markets, such as the provision of security guards, printing, payroll recordkeeping and paycheck issuance, and groundskeeping."

If privatization ever became a major influence in state policy, two activities would signal the change. Private firms have proven track records in liquor sales and insurance. Yet about a third of the states sell liquor and about a fourth are in the insurance business, primarily in Workers' Compensation. While there is some discussion of change for these functions, there has been little movement of them to (or from) the private sector in decades.

The major budget-motivated moves for privatization aren't closely related to the philosophical debates about the relative competence and costs of public and private sector enterprises.

To raise cash or to shift capital outlays outside the budget, some states are selling assets in sale-leaseback arrangements or replacing a policy of purchasing buildings and equipment with leasing. In order to maximize Medicaid reimbursement and follow current treatment doctrines, many states are shifting patients out of state-provided public health and mental health settings into settings where they are served by private providers, such as private psychiatric hospitals and community mental health agencies.

The truly big-ticket areas of potential privatization are being debated and, to some extent, demonstrated, but with little immediate relation to current state fiscal problems. Examples are: (1) choice in elementary and secondary education, (2) use of scholarships and other student subsidies rather than subsidizing institutions in higher education, (3) private turnpikes and bridges, and (4) contracting for spaces in correctional institutions.

ASSESSING BALANCED BUDGET REQUIREMENTS

Passing The Budget-Balancing Buck

In the many states with divided party control of the governor's office and the legislature, this year is seeing examples of attempts to make the other party's elected officials the bearers of bad news. In **Michigan**, the governor (R) sought to devise ways to rebalance the FY 1992 budget by informal consultations with legislative leaders (divided control). Democratic legislators reminded the governor that under Michigan law the governor is obligated to make findings that fiscal problems exist and take action to deal with them. The governor discharged this responsibility, but not until pointing out that the criticism last year was for acting without consultations Democrats thought were necessary.

In many states, as in Michigan, the governor has both a duty and the power to take administrative steps to cure shortfalls in the current fiscal year. But both the law and the politics become confusing when there are potential conflicts between appropriations, which the governor may restrict in these states, and substantive legislation. This has been the major issue in debates on the FY 1993 budget in **California**. Both houses have passed bills which give the governor considerable responsibility to decide cuts, but don't allow him to control laws that govern spending, such as those setting welfare payment levels. The governor argues this approach is unacceptable. His approach, scheduled to be put before voters by initiative petition, would give him more unilateral power than legislative leaders find acceptable to revise substantive legislation in the name of budget cutting.

Gubernatorial Leadership And Executive Budget Concepts

What happens when the problem of balance arises for the following year? The governor clearly has no power, as the legislature has the power to set both appropriations and tax levels. The governor's obligation to recommend a balanced budget has already been discharged. When, given more current information about revenues and spending, everyone concedes that the budget doesn't balance, must the governor revise the executive budget recommendations? The situation is not contemplated in state constitutions and generally not covered by state budgeting statutes, so the governor isn't required to make formal amendments to the spending and tax recommendations. But when governors don't act in these situations, they violate the concept of the executive budget.

The executive budget makes sense on two bases. The first is that chief executives are needed to provide leadership and a sense of direction. The second, more mundane one, is that an executive agency is needed to keep budget concepts (e.g., handling price and pay assumptions) consistent and to formulate and implement the details of a budget, as well as to staff the chief executive's leadership role. Using this concept, some governors make adjustments in their recommendations throughout the legislative process. By doing this, they always maintain the posture that their recommendations are what they, under present circumstances, believe to be best for the state and consistent with balanced budget requirements. Sometimes the changes to the original budget are formal amendments to the budget recommendations. Usually, they aren't.

All this works reasonably smoothly in some situations, but not others. Though few in the Empire State would agree, **New York** is a consistent example of such a smooth process. **California** sometimes is and sometimes isn't. This year, it isn't. In California, the governor concedes that the estimates underlying his budget are overly optimistic. The obvious conclusion is that (short of incredible degrees of gimmickry) California must either raise taxes or not honor the constitutional requirement for automatic growth in spending for elementary and secondary education and community colleges. No one wants to be the first to say this, or to pick a solution to advocate. So in California, as in Michigan, governors and legislators each waited for the other to make the first move.

It is not necessary to have an executive budget at all. The legislature can collect budget recommendations from state departments and interest groups, develop its own starting point for consideration, and move to enactment with no input from chief executives. The Congress operated this way until 1921. Many states -- most notably **Mississippi**, **South Carolina**, and **Texas** -- have functioned this way with variants such as gubernatorial participation on a budget board or an executive budget which isn't necessarily the starting point for legislative deliberation. Some states with strong executive budget principles in their laws use a legislative system in practice, with **Colorado** a long-standing example.

Other states have different laws and traditions. For example, in **Minnesota** and **Wisconsin**, legislators act bound by balanced budget requirements. They usually send more or less balanced packages, taxes and all, to governors even if anticipating that some of the spending will be vetoed. In one-party states, particularly in the South, the state's leadership frequently operates by consensus and the only rigid formal positions are the ones in enacted legislation. **Georgia**'s handling of its fiscal adjustments is a good example.

Another variation of the controversies over executive and legislative roles appeared this year in **New Jersey** and **Ohio**. The governors submitted budgets they contended were balanced. Their legislature made tax decisions eliminating some revenues assumed in the budget. In New Jersey, they repealed a cent of the sales tax. In Ohio, they rejected the governor's proposed increases in taxes on alcoholic beverages and tobacco. Both governors concluded that the resulting budget was out of balance.

The parallel ended when Ohio's governor announced a series of major administrative reductions in spending which he said were necessitated by the legislative rejection of his tax plan. Legislative leaders of both parties suggested the cuts were too early, too harsh, or both. New Jersey's governor didn't act as quickly. Garden State legislative leaders are saying that if the governor thinks the budget doesn't balance, it is his responsibility to use his veto and administrative powers to reduce spending. The governor's temptation was to blame an impossible situation on the legislature.

Balanced Budget Requirements In Theory

Responding to situations like these and to federal interest in state balanced budget requirements as precedent for a national balanced budget amendment, the National Association of State Budget Officers recently completed a survey of exactly how the state requirements work. The report notes that state laws may require a balanced budget at one or more of three stages: (1) when submitted by governors, (2) when enacted by legislatures, or (3) when the fiscal year ends. Individual state provisions "may not specify any of the three conditions but, instead, might simply say that the governor must ensure that there are sufficient revenues to cover expenditures contained in the budget." The report concludes that balanced budget tradition, "rather than enforcement provisions or the threat of lower bond ratings, is the most important factor contributing to balanced state budgets."

The survey of state executive budget agencies concludes that 36 governors have the power to implement budget cuts without legislative approval if necessary to maintain budget balance. Many states restrict this power by specifying that cuts must be equal in each program or that they cannot exceed a maximum amount. Except in **Indiana** and **North Carolina** where NASBO says governors have no budget veto power, governors can seek to restore budget balance by vetoes of appropriations bills and, in many states, by vetoing and/or adjusting individual line items and substantive legislation passed with the budget.

Authority to balance budgets by increasing taxes is reserved to the legislature in all states. Nine states constitutions (**Arkansas**, **California**, **Delaware**, **Kentucky**, **Louisiana**, **Mississippi**, **Ohio**, **Oklahoma**, and **South Dakota**) require more than a simple majority to pass revenue increases.

PROSPECTING FOR BUDGET CUTS

The quest for savings is primarily the responsibility of state officials, but it can include other players such as business-sponsored permanent organizations and ad hoc management improvement efforts. Recent examples come from three states.

Maine: The Special Commission on Governmental Restructuring viewed Maine's problem as part of a general over-reaching by states in the 1980s:

> *The 1980s has been called the "golden age of the states," a decade in which state revenues grew and state government became a major force in setting the domestic policy agenda in this country. In areas as widely different as welfare and education reform, as public housing and environmental protection, state government filled the policy vacuum left by a federal government strapped with mounting budget deficits.*
>
> *As quickly as states have emerged as leading players in domestic policy, they have found themselves confronting desperate financial situations. As the '80s were a decade of plenty, the 90s promise to be a decade of scarcity.*

The group concluded: "As plenty permitted the states to innovate, experiment, and extend the domestic policy agenda, so scarcity will force the states to focus on management and operations." Its recommendations included consensus revenue forecasting, fiscal notes on proposed legislation, development of six-year plans, changes in the format of the budget, and reorganization of selected state agencies. Maine's primary response to fiscal crisis so far has not been those measures but raising taxes and curtailing expensive program initiatives in such fields as health care and property tax relief.

New Jersey: The Public Affairs Research Institute has presented 22 options which it contends would produce $862 million in savings. The group's recommendations centered on issues common to many states: health care, pensions, privatization, and local government aid. Other recommendations concern state staffing and compensation including: (1) ending automatic step increases, (2) eliminating a special supplement to regular compensation for workplace injuries, (3) no longer rewarding employees at retirement for 50% of the value of unused sick leave, and (4) using contingency staffing, such as part time and seasonal workers, more frequently.

The New Jersey report suggests singling out high-paid employees for layoffs -- for example, by requiring that one in six employees making over $70,000 be eliminated in most departments. The legislature has been working with a variant of this plan, as well as the group's recommendation of substantial reduction in homestead rebates.

Concerned about the high costs of short-term borrowing, the group recommended deliberate delays in payments of vendors, local governments, and families entitled to homestead rebates. It called New Jersey a leader in the use of alternatives for incarceration for convicted offenders and urged expanding concepts like house arrest. Noting three recent well-publicized instances in which offenders in alternative correction settings have been charged with crimes, the Council commented, "requiring 100% success in any program including offenders is an unrealistic, unobtainable standard."

Ohio: The Ohio Report is the product of a business task force that produced 1,600 ideas for saving money, about $430 million a year. Many of the recommendations reflect general management principles (e.g., getting feedback from agency "customers," establishing performance measures, and involving employees in decisionmaking). Recommendations include:

Reorganization to a secretary/coordinator model with department heads reporting through a small number of cabinet secretaries as is done in California, Massachusetts, and Virginia,

Total Quality Management, adopting ideas in vogue in the private sector,

Improving Employee Training, **Program Evaluation**, and **Personnel Procedures** -- recommendations found in most business task force reports,

More Aggressively Seeking Federal Funds, including a Washington office staff position for the function and better tracking of federal grant money, and

Expanding General Obligation Debt, but reducing by an equal amount the revenue bonds Ohio issues for university buildings and other activities to avoid taking bond issue constitutional amendments to voters for approval.

Like most business task forces, the Ohio group avoided programmatic recommendations. For example, the Medicaid discussion considers issues like increasing reimbursements from third parties (e.g., Medicaid recipients also eligible for health insurance reimbursements or recoveries from auto liability insurance) and maximizing federal reimbursements, but doesn't consider restricting persons covered or services provided.

RETRENCHMENT NOT SHOWING IN PAYROLLS

Measuring how completely state leaders adjusted to recession is difficult because the relevant statistics on state and local spending have not yet been issued. One proxy is to compare the earnings gains of state and local workers with earnings gains of all workers. For both groups, earnings reflect both: (1) gains/contractions in the number employed and their hours and (2) wage and salary changes. The table shows the percentage gain for each group and the "excess," the differential earnings growths.

Percent Gain In State-Local And Total Earnings, 1990-1991
Showing Spread -- Excess of S/L Gain Over Total Gain

Rank	State	Excess	Total	S/L
1	Idaho	8.3%	3.3%	11.6%
2	Nevada	8.2	5.5	13.7
3	Maine	7.4	-1.1	6.3
4	Kentucky	6.2	4.0	10.2
5	California	6.1	2.0	8.1
6	Washington	6.0	6.4	12.4
7	Alabama	5.9	4.6	10.5
8	Vermont	5.6	0.7	6.3
9	Illinois	5.5	2.7	8.2
10	Iowa	5.3	0.9	6.2
11	New Hampshire	5.2	-1.1	4.1
12	New Jersey	4.9	1.7	6.6
13	Delaware	4.7	3.4	8.1
14	South Carolina	4.6	2.7	7.3
15	North Carolina	4.4	3.1	7.5
16	Oregon	4.4	4.4	8.8
17	Maryland	4.3	1.7	6.0
18	Pennsylvania	4.3	2.4	6.7
19	Nebraska	4.2	2.7	6.9
20	Hawaii	4.1	6.7	10.8
21	Michigan	4.1	1.2	5.3
22	Arkansas	3.9	4.9	8.8
23	Ohio	3.9	1.8	5.7
24	South Dakota	3.9	4.5	8.4
25	Missouri	3.8	2.1	5.9
26	Oklahoma	3.8	2.7	6.5
27	Florida	3.6%	3.3%	6.9%
	United States	**3.4**	**2.7**	**6.1**
28	Indiana	3.4	2.5	5.9
29	Kansas	3.1	2.6	5.7
30	West Virginia	2.9	2.8	5.7
31	Georgia	2.8	3.2	6.0
32	Louisiana	2.7	5.3	8.0
33	Wisconsin	2.7	3.6	6.3
34	Virginia	2.5	2.3	4.8
35	Connecticut	2.4	1.2	3.6
36	Arizona	2.0	3.9	5.9
37	Minnesota	2.0	2.9	4.9
38	Alaska	1.9	4.6	6.5
39	Utah	1.5	6.9	8.4
40	New Mexico	1.2	6.2	7.4
41	Texas	0.9	5.5	6.4
42	Tennessee	0.6	4.0	4.6
43	Colorado	0.5	6.2	6.7
44	New York	0.5	0.6	1.1
45	North Dakota	0.2	4.4	4.6
46	Mississippi	0.1	4.4	4.5
47	Massachusetts	0.0	-0.2	-0.2
48	Montana	-0.1	7.5	7.4
49	Wyoming	-0.8	7.4	6.6
50	Rhode Island	-3.6	-2.3	-5.9

Nationwide, state and local pay grew by 6.1%, above the 5.2% expected if payroll growth reflected inflation (4.2%) and population growth (1.0%) during 1991. Recession-depressed private earnings growth was only 2.7%. So, state and local earnings growth surpassed total earnings growth by 3.4%, the "excess" for the United States in the table.

There are massive differences among the states in each of the three categories on the table. The differences are most narrow for total earnings. These declined in four states and showed the highest growth in **Utah** with 6.9%. In six states, led by **Nevada** with 13.7% growth, state and local earnings grew by more than 10% in one year. But two states, **Massachusetts** and **Rhode Island**, actually reduced state and local payrolls.

That state and local payroll growth exceeded private sector growth in 1991 isn't surprising. The budgets involved were those of FY 1991 and FY 1992, before the impacts of revisions made in late 1991 and early 1992. The recession caught most state and local governments at a time when their budgets were predicated on normal economic growth. Adjustments lagged revenue shortfalls because of delays in recognizing the problem, planned hedges like rainy day funds, and reluctance to make the tough decisions involved.

In some states, the economy was skidding at the same time state revenues were buoyed by recent tax increases. Those examples -- like **California**, **Illinois**, **New Jersey**, and **Pennsylvania** -- understandably rank high in the "excess" column. Other states with high "excess" enjoyed economies that had been thriving, generating substantial spending increase momentum. Examples are **Idaho**, **Nevada**, and **Washington**.

There were several formulas for keeping the "excess" state and local payroll growth low. One was having rapid growth in the private sector to match rapid growth in the public sector, as occurred in **Colorado**, **Montana**, **New Mexico**, **Texas**, **Utah**, and **Wyoming**. Another was to maintain state and local payroll growth well below the national average as was done in **Connecticut** and **New York**.

The impact of differing responses by state officials and differing interaction of state and local finances appear clearly among New England states, where the recession came earlier than in the rest of the nation. **Rhode Island** made the most decisive adjustment in public payrolls, as the state retrenched sharply to cover both recession-induced revenue loss and heavy outlays caused by failing financial institutions. Its retrenchment quickly and decisively affected universities and local government as well as regular state employees. **Massachusetts** made similar, but less deep, cuts to be among the four states where state payroll adjustments matched or exceeded those of the overall state economy.

Three other New England states show some of the largest "excesses" on the table. **Maine** was the most severe case because its officials, particularly the governor, refused to recognize the seriousness of the state's revenue problem. **Vermont** maintained rapid spending on payrolls by a combination of local taxes and a state tax increase. **New Hampshire** local governments are little affected by state fiscal conditions because there is little state aid to cut. Property tax revenue growth associated with previous real estate price increases helped propel local payrolls upward even when the state's economy was contracting.

LOCAL GOVERNMENT FINANCES AT RISK

Local Aid Cutbacks: The Fiscal Survey Of The States published by the National Association of State Budget Officers this spring included a summary of strategies for eliminating FY 1992 budget gaps. The three most popular, each mentioned by 18 budget offices, were: (1) eliminating programs, (2) reorganizing programs, and (3) reducing local aid. Another table showed that 24 governors proposed local aid changes in their FY 1993 budgets. Most of these were aid cuts adversely affecting local finances. Those helping local fiscal situations were generally costless to states, such as giving local governments more taxing authority and providing relief from state mandates. Local governments in a few states were also affected by state tax increases. **Minnesota** ended exemptions for local government purchases. **New Mexico** began to tax certain local government sales.

In most states, the pattern is to attempt to protect school aid and even increase it while general purpose aid, such as revenue sharing for cities and counties, is cut. In states following this strategy, like **Massachusetts**, where municipalities run schools, this difference in treatment doesn't make much difference. In most states, it means that aid to school districts is increasing while aid to cities and counties is being frozen or cut. The governor's proposals for the **Illinois** budget are an example. Federal aid has also been shifting. More money is flowing to schools and to states for AFDC and Medicaid and less is going to cities and counties.

State Mandates: Unfunded federal mandates remain a major concern of state officials, with constant fear that federal elected officials will deal with their desires to make policy and their lack of money by making policy in the form of mandates. Local officials have the same concern about state officials. They recently pooled their experiences in a report which predicts that state "unfunded requirements to local governments will only increase in the next decade as the intergovernmental roles of states as rule givers and localities as rule takers become firmly entrenched."

Local officials in many states have mounted systematic campaigns to reduce the impact of mandates, to prevent new mandates by fiscal note and reimbursement requirements, and to shift costly programs such as indigent health care to the state level. As with studies of federal mandates to states, there are studies reporting massive fiscal impacts of mandates. For example, a recent study in **New York** cites an estimate that mandates account for 71% of school district budgets and a range from 18% to 76% of county budgets. While rejecting these estimates as excessive, the study concludes that "the state is a major cause of local tax increases." It cites "nuisance" state mandates such as requiring towns to notify parking ticket scofflaws by certified rather than regular mail, limiting local dog license fees, and requiring New York City to pay unemployment compensation for volunteer workers.

The state record in dealing with mandates to local governments is mixed. On the one hand, there are major overall restrictions such as a 1991 **Louisiana** constitutional amendment permitting local governments to ignore unfunded state mandates. There is a similar statutory change in **Colorado**. On the other hand, many states have imposed new, federally encouraged restrictions on solid waste disposal, and a variety of state requirements ranging from records management in **Utah** to juvenile detention in **Montana**.

The Overall Impact Of State Policies: While it is too early to tally the score from state actions affecting local government this year, the pattern is likely to resemble the one found by Steven Gold in his assessment of 1991 actions. He found that "at least" 15 states reduced aid to municipalities and/or counties, cited only one major increase (**Pennsylvania** which paid for increasing aid with one of the largest tax increases in the nation), and found that at least a third of the states enhanced local ability to raise revenue. While stating that most states didn't single out cities and counties for especially harsh treatment in 1991, he concluded that states didn't do as much as he thought they should:

> *On the other hand, states did not do much to help local governments in any significant way either. The problems of cities and counties remained a low priority in most state capitols. States were so preoccupied with their own budget problems that local fiscal stress did not receive the attention it deserves.*

Local Responses: The initial impact of state actions in 1991 and this year on local government was muted in many states by two developments favorable to local finances. The first was fiscal relief from declining pension contributions. As states reduced their contributions for state employees because of improved actuarial outlooks and fiscal pressures, local contributions dropped as well. In some states, the same pension plan is used for state and local employees. In others, parallel changes were made in all state-administered plans, including those for local employees and teachers as well as those for state employees. Because of lags in assessment procedures, local property tax bases (based on assessed value) were often rising even as local property values were stagnant or even falling. Both these factors had primarily temporary effects.

As the temporary effects disappear, local officials have been making budget adjustments which have often been as substantial and as difficult as those of their states. These have been striking in **New York**, particularly in the major counties surrounding New York City, and in **Massachusetts** where local property taxes are limited by state law and local governments don't have the option of using local option sales or income taxes. In Cook County (Chicago area), the county board president blamed **Illinois** mandates for shortfalls in the county's nearly $2 billion budget, and recommended a county-wide sales tax that would raise sales taxes in Chicago (where customers would pay sales tax to the city, county, and state) to 8.75%.

The Outlook: The changes occurring in the past several years in state fiscal relations with local governments outside education don't appear to be the simple results of state fiscal problems but rather longer term trends accelerated by fiscal problems. With some notable exceptions, state policy seems to be moving in the direction of a sorting out of state and local roles. That sorting out discourages special state aid formulas to provide general revenues to local areas, even fiscally distressed ones, but encourages state takeovers of functions, like the movement to take over local Medicaid costs in **New York**, that bear most heavily on fiscally stressed jurisdictions. The trend discourages indirect local fiscal relief by eliminating or reducing special deductions for property taxes while increasing local fiscal options by new local taxing authority. Understandably, not all state and local officials are equally enthusiastic about such changes.

LOOKING FOR HEALTH CARE SOLUTIONS

State officials aren't giving up in their quest for health care financing solutions, but their journey isn't getting any easier.

Barriers To Dealing With Self-Insured Employers

Under the Employee Retirement Income Security Act (ERISA), states cannot directly regulate employer-provided benefits such as pension and health plans. States can regulate insurance of all types, so states have mandated minimum benefits (e.g., coverage of mental health and substance abuse) in health insurance plans. These mandates and state insurance premium taxes have caused employers increasingly to provide the substance of health insurance without its form, through what has become known as *self insurance*.

Employees see no difference between regular insurance and self-insurance. The benefits are the same and the claims processor is often an insurance company. But legally, self-insurance isn't insurance at all because the employer isn't buying protection against risk. The employer bears the risk that claims will be greater than anticipated, but reaps the gain if they are lower than anticipated. The plans don't require an insurance company, but those companies are often hired as claims processing agents, not as insurers.

The ERISA situation has made state-mandated benefits barely tenable. Large employers can avoid insurance while small ones need insurance to hedge against bad luck in the health of their employees. So the mandates are effective only for small firms. Small business leaders have sought relief from legislatures and, in an unknown number of cases, dropped insurance rather than providing the costly mandated coverages. In this situation, some states have adopted special encouragements for "basic" plans -- little more than positive rhetoric to cover exemptions from the mandates applied to small employers.

Besides eroding the effectiveness of mandated benefits, the ERISA situation has forced state proposals for universal health coverage to be packaged as "play or pay" plans, hung on the legal hook of state taxing power rather than state power to regulate. At a minimum, such plans would be subjected to major challenges in the courts.

A more immediate problem is the **New Jersey** holding that ERISA preempts surcharges on hospital bills to pay for indigent care (see Issue 12). The decision is on appeal. Meanwhile, legislators briefly extended the Uncompensated Care Trust Fund to give themselves enough time to decide what to do. Two **Connecticut** employers, Hewlett Packard and Pepsi Cola Allied Bottlers, have initiated similar litigation in that state. Several other states, including **Massachusetts**, have comparable plans. State officials are worried that future ERISA-based challenges could threaten the newly enacted **Minnesota** plan for uncompensated care. Other state policies, such as **New York**'s differential hospital charges, are also at risk and perhaps even some Medicaid provider taxes.

These concerns were serious enough to send a delegation of 14 governors to the White House in late June to attempt to convince Bush Administration negotiators to back some form of exemption legislation in the Congress. Neither major business groups nor the Administration has shown much enthusiasm. They oppose the state mandates of services, don't like proposed state health financing plans that appear to put more money into health care without addressing cost control, and some are concerned about taxes on health insurance. Prospects for Congressional action before November are miniscule.

Never Give Up

Despite the massive obstacles to single state universal health plans, many legislators support such plans. In June, the **New York** Assembly passed one. It provides a common plan to replace Medicaid and private health insurance as well as cover the uninsured. Funding would come from a 10% payroll tax (8% on employers, 2% on employees) plus a special tax on unearned (non-wage and salary) income. The measure passed on a party-line vote, viewed by the Democrats who supported it more as an attempt to dramatize the issue than pass legislation this session. The Senate Republican leaders say they will soon have a plan of their own with different financing.

A blue ribbon group in **Montana**, Health Care for Montanans, has rejected universal care on a state-by-state basis on the grounds that the medically uninsured with substantial health problem would flock to a state that provided it. It is pushing more modest suggestions, including medical malpractice reforms and an attempt to become the first state in the nation to adopt a uniform electronic billing system.

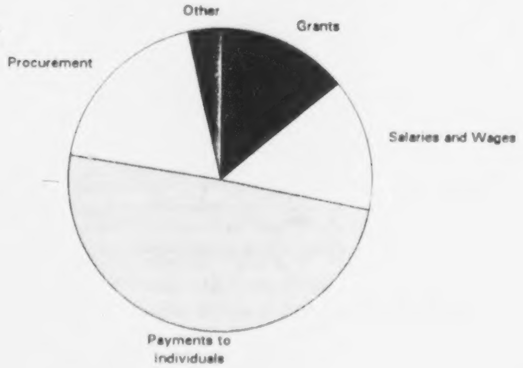
FEDERAL IMPACTS ON STATE FINANCES

For at least the remainder of 1992 it appears that federal policy changes will have little impact on state finances for the simple reason that few changes in federal policy appear likely. Most of the current action is in Medicaid reimbursement decisions. The situation is likely to change next year as federal officials get more serious about budget cutting, particularly in defense, and about new mandates.

Coveting Federal Payrolls And Contracts

The impact of federal procurement and payrolls on state economies is so substantial that many states have special programs to attract and retain federal installations and to assist firms in their quest for federal contracts.

Percentage Distribution Of Federal Spending Attributable To Individual States, FY 1991



As shown by the pie chart, federal payments for individuals (see Issue 12) dwarf the significance of payrolls and contracts. But large amounts are involved. In FY 1991, federal procurement awards amounted to $811 per capita. In nine states, over $1,000 per capita came from federal purchasing decisions.

Wage and salary payments to federal employees have nearly as large an impact. Those payments were $611 per capita nationwide in FY 1991. The federal payroll was over $2,000 per capita in **Alaska** and **Hawaii** and over $1,000 per capita in **Maryland** and **Virginia**.

Federal Purchasing, State-By-State

Federal purchasing decisions have highly uneven impacts among the states. The top-ranked state has per capita amounts nearly eleven times those of the lowest-ranked state. Eighteen states capture procurement dollars that are less than half the national average. There appears to be a minimum amount of federal purchasing associated with local purchases of post offices, military recruiting stations, and IRS offices. Nine states, with per capita purchases of $200-300, appear to get little more than this level.

Per Capita Federal Procurement Awards, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	New Mexico	$2,237	17	Utah	$810	34	North Dakota	$383
2	Connecticut	1,621	18	Mississippi	795	35	Georgia	377
3	Virginia	1,585	19	Texas	758	36	West Virginia	348
4	Maryland	1,519	20	Washington	711	37	Illinois	344
5	Alaska	1,413	21	Hawaii	670	38	Oklahoma	325
6	Missouri	1,412	22	Ohio	611	39	North Carolina	320
7	Colorado	1,367	23	New Jersey	592	40	Wisconsin	303
8	Massachusetts	1,360	24	Florida	563	41	South Dakota	302
9	California	1,057	25	Kentucky	550	42	Nebraska	299
10	Idaho	984	26	New York	547	43	Wyoming	294
11	Tennessee	984	27	Louisiana	507	44	Delaware	279
12	Maine	938	28	Minnesota	478	45	Iowa	258
13	South Carolina	911	29	Rhode Island	460	46	Michigan	246
14	Nevada	882	30	Kansas	457	47	Montana	240
15	Alabama	846	31	New Hampshire	453	48	Oregon	219
16	Arizona	826	32	Indiana	436	49	Vermont	210
	United States	**811**	33	Pennsylvania	402	50	Arkansas	205

The key to a high ranking is to have major federal contractors oriented to defense procurement, like **Connecticut** and **Missouri**, or a specialized function, like atomic energy in **New Mexico**, or a combination such as defense and health-related federal activities in **Maryland**. The states most at risk from a cutback in federal spending are probably those with high dependence on defense contracts. The most vulnerable are **Connecticut** ($1,500 per capita in defense contracts in FY 1991), **Missouri** ($1,213), **Massachusetts** ($1,149), **Virginia** ($1,064), **Alaska** ($973), and **Maine** ($851).

Federal Payrolls, State-By-State

The table (next page) shows the wide range of impacts of federal payrolls on the states. The per capita payroll was more than nine times as high in **Alaska** as in **Wisconsin**. Four states are more than twice the national average. Three states are less than half of it.

A portion of federal payrolls is related to functions that must closely approximate population, such as delivering the mail and collecting taxes. These activities seem to set a base of about $250 per capita, which is about all the federal payroll to be found in **Iowa**, **Michigan**, and bottom-ranked **Wisconsin**. The remainder of the federal payroll is primarily related to the location of federal facilities, such as military bases, and to federal activities that are by their nature unevenly distributed among states such as administering agricultural subsidies and federal land holdings.

Per Capita Federal Wages And Salaries, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Alaska	$2,236	18	Kentucky	$663	34	Massachusetts	$470
2	Hawaii	$2,042	19	North Carolina	636	35	New Jersey	454
3	Virginia	$1,805	20	Nebraska	624	36	Pennsylvania	439
4	Maryland	$1,334		**United States**	**611**	37	Tennessee	437
5	Colorado	945	21	Delaware	611	38	Illinois	432
6	New Mexico	921	22	California	610	39	Oregon	420
7	Utah	840	23	Missouri	587	40	Arkansas	409
8	North Dakota	838	24	Rhode Island	576	41	Connecticut	396
9	Georgia	781	25	New Hampshire	568	42	Vermont	387
10	Washington	779	26	Texas	568	43	New York	376
11	Oklahoma	773	27	Arizona	566	44	Ohio	374
12	South Dakota	740	28	Nevada	544	45	West Virginia	357
13	South Carolina	730	29	Florida	524	46	Indiana	339
14	Alabama	714	30	Mississippi	517	47	Minnesota	317
15	Kansas	714	31	Idaho	502	48	Iowa	278
16	Wyoming	703	32	Louisiana	490	49	Michigan	270
17	Montana	671	33	Maine	470	50	Wisconsin	249

Federal Contribution To State Fiscal Stress: A recent report from the Center for the Study of the States concluded, as **Reports** does, that federal aid cuts *are not* the source of current state fiscal problems -- though other federal actions and inaction are major problems. The report comments:

> *Federal policies have contributed considerably to recent state fiscal stress in a variety of ways. The most important effects occurred through the Medicaid program -- the fastest growing part of state budgets -- and the recession, which depressed revenue and increased welfare and Medicaid spending.*
>
> *Federal aid reductions have not been an important source of recent state fiscal stress... Federal policies have affected state finances in several other ways -- through tax policy, new unfunded mandates, and the federal failure to cope effectively with problems like health and poverty. Federal court rulings have also caused budget problems (as have state court decisions).*

The latest data from the national income accounts show that federal aid to state and local governments rose 14.5% from the first quarter of 1991 to the first quarter of 1992. During the same period, state and local receipts from their own sources (e.g., taxes and user charges) rose by much less, 6.2%.

Recent attempts to make major changes in federal fiscal patterns have failed. Proposals for massive new urban aid programs and recession-fighting infrastructure aid have become urban aid packages that simply increase funding for some existing programs and expand enterprise zones. The balanced budget amendment, which under some scenarios could result in major cutbacks of federal grants, is making little progress in the Congress.

Federal Mandates And Preemption: This has been a relatively quiet year for Congressional action on mandates to state and local government. There are, nonetheless, many examples of mandate activities: (1) affordable health care proposals that would restrict state ability to mandate benefits and, in the President's proposal, threaten state insurance premium taxes on health insurance, (2) preemption of aspects of state utility regulation and new building code mandates in the pending energy legislation, (3) restrictions on state revenue-raising flexibility and new penalties to be imposed on states in reauthorization of the Resource Conservation and Recovery Act, and (4) cost-increasing regulations associated with the Americans with Disabilities Act.

Medicaid And Politics: The increasingly widespread use of Medicaid bootstrap financing devices and state claims for retroactive Medicaid reimbursement seem to have made some federal Medicaid decisions increasingly political, in appearance if not in substance. The most obvious current case is **New Jersey**. Legislative leaders (R) there were working with the White House for what amounts to direct inputs to the pending budget. The culmination of the process occurred in late June when the leaders announced that an additional $84 million in retroactive payments would be available. They immediately allocated the money to reverse some of the cuts in their budget package, such as raises previously negotiated with unionized workers. Democrats proposed an alternative use, restoring cuts made in the homestead rebate program.

MISCELLANY

Legal Challenges To Higher Education Spending

> *We may have to call out the National Guard because I'm just not going to do it.*

On reflection, Governor Fordice decided this wasn't something that a **Mississippi** governor should be saying in 1992 about federal desegregation orders. It evoked strong memories of a prior governor standing at the schoolhouse door to block desegregation in the 1950s. The corrected version from the governor's press secretary is: "We don't need the {federal} interference to any degree in trying to tell us how to spend what little monies that we have in Mississippi."

Southern officials may have less to worry about than officials of states like **California**, **Illinois**, and **New York**. A new line of cases may do to state funding of universities what the equalization suits have done to public school funding. This was little noticed in the larger states until a suit was filed in **New York** in February that relies on the same legal principles at stake in the cases in **Alabama**, **Mississippi**, and **Texas**.

Desegregation In Southern Universities: Through the 1950s the states of the Old Confederacy maintained racially separate public higher education systems, effectively baring all or all but a few token blacks from white schools. The black schools were generally inferior in facilities, budgets, academic reputations, and achievement levels of students before admission and after graduation. There were a few cases of "separate but equal" higher educational institutions in the North, but not whole university systems as in the South.

A combination of compliance with desegregation laws, policy preferences, and the politics of holding power in states with large percentages of black voters essentially eliminated discrimination against students by race. For decades, a black Mississippi resident has had an equal or better chance of admission and graduation from the flagship institutions as an equally qualified white resident.

Equal Access Doesn't End The Debate: One could argue, as Mississippi and other states did, that equal or better-than-equal access for students should end the issue. Federal officials didn't accept this view. In some Southern states, they tried to promote more integrated institutions than unfettered student choice alone would provide. Mississippi provided an ideal environment because the formerly white flagships are away from the major center of population growth in Jackson. It is served by Jackson State, a formerly black institution. By blocking expansion of the flagships in the Jackson area, the courts could create a monopoly market for Jackson State, thereby encouraging whites to attend it.

These strategies didn't work for regional four-year institutions that were the growth products of junior colleges and teachers colleges throughout Mississippi and other states. There the formerly white institutions proved a stronger draw for both black and white students with funding for operations more or less following enrollment and funding for new buildings more or less following enrollment growth. At this point, Mississippi and similarly situated states could argue that: (1) students had choices unfettered by discrimination, (2) the formerly white schools were in fact integrated, and (3) the allocation of funds among schools was color-blind or, in many cases, biased toward the formerly black institutions. Various other adjustments were being made, such as adjusting university governance in Louisiana to wipe out the vestiges of separate black and white systems.

Funding Disparities In the North And West: While this was occurring in the South, Northern states were dealing with their problems of having flagship universities not serving urban centers by (1) permitting flagships to establish branches and professional schools in the centers, (2) accepting state responsibility for formerly municipal systems such as New York City's system, (3) providing extra aid to private institutions in urban centers, such as the University of Pittsburgh and Temple, and (4) creating new major institutions to aspire to flagship status, such as Cleveland State and the University of Illinois (Chicago). Some newer institutions such as state institutions in Northern central cities and along the Texas-Mexican border inherently tended to have predominantly minority students.

Developments In The Courts: The Mississippi case drew national attention even before it was decided by the U.S. Supreme Court in June. Last October, President Bush directed the Justice Department to withdraw its brief supporting Mississippi and to argue the case against the state's position. The new federal position prevailed in an 8-1 Supreme Court decision in June. The case will now go back to lower courts where the question of what Mississippi must do will probably be litigated for years. A similar case in Alabama has already produced larger budgets for the predominantly black institutions, but more litigation may occur there and in other states.

The Mississippi case involved unwinding a history of segregation but the cases in **New York** and **Texas** don't depend on that factor. The plaintiffs contend that the City University of New York, with predominantly minority students, receives less per pupil than the State University of New York with predominantly non-minority students. Both the legal principles and the facts are at issue. While SUNY gets more aid per pupil, much of the differential, perhaps all, may be explained by the concentration of high cost medical and other professional programs at that institution. In the Texas case, the funding differentials between the South Texas institutions (with mostly Hispanic students) and the University of Texas are similar to those between flagship and regional institutions in other states.

The New York case is in trial court. The Texas case is on appeal. Other states will likely experience similar litigation, following the pattern of the public school finance equalization cases. The "years of litigation-driven confusion and destabilization" predicted by Justice Scalia's dissenting opinion in the Mississippi case do appear likely.

Rating Professional Licensing Boards

Oklahoma and **North Dakota** do four times better than the national average in regulating physicians while **Massachusetts** and several New England states do half as well. This conclusion, and ones like it for licensing boards in other regulated professions, can be reached from data regularly published by associations of state agencies such as the Federation of State Medical Boards.

These associations don't rank their members. They do provide comparable statistical information on such subjects as the number of regulated professionals in each state, the number suspended or otherwise disciplined, and the budgets of the agencies. Some consumer groups, such as the Public Citizen Health Research Group, convert these data into rankings, usually on the theory that the more disciplinary actions taken, the more effective the licensing agency.

The licensing agencies aren't comfortable with these rankings. The approach is comparable to comparing state highway patrols by the number of tickets written rather than by accident rates or average highway speed. But the rankings can have an impact, particularly when combined with well-publicized disciplinary situations. This recently happened in **Massachusetts**. The nationally publicized case involved a female psychiatrist whose sexual relationships with a patient allegedly led to his suicide.

In Massachusetts, as in many states, the fees paid by doctors and other professionals for their licenses to practice enter the general fund. Operating expense appropriations for regulation are often less than the fees. Groups representing the licensed professionals often lobby for earmarking of fee revenue for the regulatory agency, reasoning correctly that this would provide a natural limit on the level of fees. State fiscal officials often reject this approach because of objections to earmarked revenues generally and potential revenue losses in particular cases. Reforms announced by the governor in Massachusetts involve raising physicians' fees and earmarking the revenue for regulation while leaving the general fund with a large cut of current fee revenue.

Water Supply Projects

Throughout the West and in limited circumstances East of the Mississippi, the federal government operates major systems of dams and reservoirs without which irrigated agricultural activity and even urban development in arid states would be massively less significant than it is. The state role in these projects has usually been limited to parkland development and dealing with fishing and recreational uses. The big trade-offs -- like whether water goes to agriculture or urban development and whether flows are maintained for fish rather than keeping water stored for irrigation -- are federal choices.

Two developments are encouraging greater state interest. The first is that the federal budget isn't providing for much new investment. The second is that there are strong pressures in the Congress and the federal executive branch to change some of the rules in ways agricultural interests view as unfavorable.

One sign of interest is the continuing effort in **North Dakota** to put up large sums of state money for state-funded water development. The proposal was seriously considered in the legislature and may be put on the ballot by initiative.

Another sign of interest was the February announcement by Governor Wilson that he wants **California** to take over the Central Valley Project from the federal Bureau of Reclamation.

Access to water in the West has been a source of controversy since settlement began, as any reader of Western novels can attest. A new 141-page study by the Advisory Commission on Intergovernmental Relations concludes that water problems are largely problems of coordination and management, rather than problems of scarce supply. Access problems also affect the East. For example, **Alabama** officials are concerned with **Georgia**'s interest in diverting water from rivers that flow into Alabama. A water planning bill was proposed by the governor to establish an agency to deal with the situation, but wasn't adopted in the recently concluded legislative session.

Also Noted: The Federation of Tax Administrators has done a survey of revenue estimating procedures and organizational responsibilities in the 50 states. Results appear in Tax Administrators News (March and earlier issues). Governor Weicker collected a courage award worth $25,000 from the John F. Kennedy Library Foundation for his role in enacting the new **Connecticut** income tax. His comment: "I'm not in the courage business, I'm in the governing business." **Oklahoma** acted this year to maximize use of federal funds by converting its sales tax relief from a refundable income tax credit into a supplement to cash welfare assistance, thereby making it a welfare payment eligible for cost sharing.

West Virginia is nearing the end of its attempts to recover an estimated $257 million in securities trading losses incurred by its investment of pooled state and local cash balances. It has recovered $28 million from settlements with securities firms, won $32 million (plus interest) from Morgan Stanley in a trial court decision being appealed, and has a $14 million case left against Chase Securities. The legal bill will be substantial. **Iowa** is less advanced in attempts to recover about $75 million for its pooled investments. The Iowa case clearly involves fraud by private firms with state errors in the selection and supervision of firms. The West Virginia case involves excessively risky practices by state officials, but no allegation that the firms or their employees absconded with any money. Even the best conceivable legal outcomes will leave state and local governments in both states with massive losses.

The process of states getting out of the business of insuring financial institutions -- savings and loans, banks, industrial banks, and credit unions -- also appears to be nearing an end after the big hits taken by taxpayers in **Maryland**, **Ohio**, and **Rhode Island**. The most recent state to take a loss is **Pennsylvania** which will be terminating the Pennsylvania Deposit Insurance Corporation. One of the three remaining covered banks has joined the Federal Deposit Insurance Corporation while the state has seized the other two. Money in the state Workers' Compensation insurance fund will be used, with no immediate general fund impact. The fund will temporarily own the banks.

TECHNICAL NOTES

State Finances: Two recent additions to the literature of privatization are Edward Hudgins and Ronald Utt, eds., How Privatization Can Solve America's Infrastructure Crisis (Heritage Foundation, 214 Massachusetts Ave., NE, Washington, DC 20002) and Reinvigorating The Public Service (Public Employee Department, AFL-CIO, 815 16th St., Washington, DC 20006). The second volume reflects efforts by public employee groups to show that gains in service delivery don't depend on who does the delivering. A section of Governing (May) includes a directory of "Who's Who in Privatization," assesses privatization in four fields, and concludes, "The privatization trend shows no signs of slowing."

The NASBO survey is State Balanced Budget Requirements: Provisions and Practice (June). PARI (212 Carnegie Center, Princeton, NJ 08540) summarized its cost-cutting recommendations in its Public Affairs Focus (June). The Ohio Operations Improvement Task Force (77 S. High St., Columbus, OH 43266) issued its report in November as Bringing Out The Best In Ohio. The Maine recommendations are found in Legislative Document No. 2330. The table on comparative earnings growth was developed by **Reports** from data appearing in the Survey Of Current Business (April).

Local Finances: The National League of Cities (1301 Pennsylvania Ave., NW, Washington, DC 20004), produced State Mandates: Fiscal Notes, Reimbursement, And Anti-Mandate Strategies. The 78-page report includes tables detailing each state's fiscal note and mandate-limiting laws. The New York study is Taking The Credit & Shifting The Blame (The Empire Foundation, 301 Hamilton St., Albany, NY 12210). Gold's assessment, State Policies Affecting Cities And Counties In 1991, was recently published by the Center for the Study of the States (411 State St., Albany, NY 12203).

Federal Impacts: The report, The Federal Role In State Fiscal Stress is also from the Center for the Study of the States. NCSL's monthly Mandate Watch List, provides a detailed running tabulation of mandates and preemptive legislation pending in the Congress. For a good summary from a state perspective, see "U.S. Adds Programs With Little Review Of Local Burdens," New York Times (3/24).

Water Supply: The Advisory Commission on Intergovernmental Relations (Washington, DC 20575) study is Coordinating Water Resources In The Federal System: The Groundwater-Surface Water Connection. For a summary of California's continuing controversies, see California Journal (June).

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Correction, Tennessee Health Provider Taxes: The Issue 11 characterization of Tennessee's new tax on health care providers got the economic effects right but the law wrong. The tax changes appear to provide a broad-based new tax on health and non-health activities. But the non-health activities escape added taxes by repeal of the old taxes on them, not by a credit against the old taxes.

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Editorial Note: To end the bias of writing about state policies from a Washington area location, **Reports** editor Hal Hovey has relocated to Columbus, Ohio. The editorial office remains in Virginia (new address and phone in box below). There is no change in the subscription office.

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IN THIS ISSUE

Escalating costs keep health care financing at the top of state agendas. But there hasn't been much progress in making health care more affordable. Major reform measures passed this year by four states offer only slow changes. Fiscal problems preclude significant taxpayer subsidies of health care. There is considerable interest in plans that underwrite insurance for the hard-to-insure with premiums from other insurance customers.

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Cost pressures are forcing consideration of Medicaid cost cuts and new provider taxes. The taxes are more popular than the cuts because officials of many states fear cuts would just shift costs to other programs and private insurance.

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With lotteries showing little growth, states are betting on new forms of gambling. More casinos are likely to be approved. Some lotteries are offering about the same betting opportunities as popular casino games.

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This election-year summer, most states are postponing budget adjustments. Higher education is the big loser from fiscal stringency.

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A note contrasts conventional economic wisdom with assertions about impacts of gambling. Technical notes cover new information on health care finance and detail sources and caveats.

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STATE
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July 1992 (Second Of Two July Issues)

DEVELOPMENTS IN HEALTH CARE FINANCING

State officials continue to look for health care financing solutions that offer dramatic results but don't drain tight budgets. **The search isn't producing much.**

HEALTH CARE ISSUES HEAT UP IN STATEHOUSES: Kansas, Missouri Legislators Wrestle With Bills, Action Unlikely -- headline Kansas City Star (3/13)

Tight state finances have slammed the brakes on proposals that depend upon state subsidies or tax credits to encourage expansions of health insurance. Expansion by mandating private coverage is stalled by two massive obstacles. The first is the federal Employee Retirement Income Security Act (ERISA). As discussed in Issue 13, it provides a major impediment to new state plans and jeopardizes some existing state programs which spread the costs of the uninsured over all health care consumers. The second is the reluctance of state officials to raise taxes on anyone and particularly on employers in competition with those of other states and nations.

The lack of progress is evident in a new book assessing state options for improving access to health care. It examines the alternatives considered by a governor's task force in Michigan that reported in 1990. The same list of options is considered by similar task forces in other states. The editors conclude:

> *Since then, a major recession has struck Michigan and many other states. State budget deficits have soared, as has the federal budget deficit. Most states are struggling to fund the expansions of the Medicaid program mandated by the federal government during the late 1980s and have backed away from new initiatives to improve access to health care. ... In Michigan, tight state finances have led to a backward movement on health care access improvement through the elimination of the General Assistance program. Other states have taken similar measures.*

This report concludes: "The dire financial predicaments of many of the states have clearly shifted the focus of health care reform back to the federal level." But what little action is developing in Congress this year is devoted to apparently costless ways to increase the availability of care by such devices as insurance regulation and tort law reform.

Most state officials continue to favor the federal actions suggested in a new report by the Advisory Commission on Intergovernmental Relations. They include federal takeover of nursing home costs, 100% federal payment for new federal mandates, greater state flexibility in administering Medicaid, and comprehensive health care reform as a national, not state, responsibility. The report also echoes a point constantly made by state officials about the limitations on what they can accomplish through the Medicaid program:

Modifications to Medicaid will yield only marginal improvements in the health care system because Medicaid accounts for only 12% of all health care expenditures. Without effective methods of cost containment, any improvements in Medicaid's efficiency and effectiveness resulting from these improvements may be wiped out by rising costs.

STATE HEALTH INSURANCE REFORMS ARE POPULAR

Legislation and/or administrative action to "reform" health insurance is being discussed in practically all states, and implemented in many. **The objective of the reforms is to improve the position of a relatively small target group with big problems in getting or paying for coverage.** Typical target groups are: (1) uninsurable persons, such as those with chronic diseases, (2) transitional situations, such as persons changing jobs or employers changing insurance carriers, to prevent loss of coverage because the new carrier won't cover preexisting conditions, and (3) individuals and small businesses facing sharp premium increases because of high past claims.

The reforms often are discussed as though there were no costs involved. The situation parallels other cross-subsidies such as "lifeline" and "basic service" utility rates. The reforms parallel assigned risk plans in auto and fire and casualty insurance and bars against life and auto insurance underwriting criteria viewed in some states as bad public policy (e.g., age, sex, location of residence, past auto or health claims).

With no new money on the table, higher rates for those without the targeted problem finance lower rates for those with the targeted problem.

The claim is often made in state debates that companies will absorb the costs of controlled rates for target groups. But legislation seldom contains the teeth required to support this claim. As a result, many of the plans have been backed by some insurers, suggesting that relief for the target groups will come from other insurance customers rather than company profits.

Occasionally, claims that insurance companies will absorb costs have been backed by legislative requirements, such as those of Proposition 103 (auto insurance) in **California**. The result then becomes litigation over whether the legislation is an unconstitutional taking of private property and threats that companies will reduce the availability of insurance. The ultimate reduction is company withdrawal from the state, a problem **Vermont** is currently experiencing with health insurance carriers.

The newest experiment is "community rating" (as distinct from rating individual persons and small employers). One such plan becomes effective in **New York** in April 1993 as a result of recent state legislative action.

New York has traditionally maintained a two-tiered health insurance market. Blue Cross/Blue Shield, with 2.1 million subscribers, has been taking many of the higher risk cases while private insurers have captured the lower cost group policy market. To attempt to keep the system tenable, the Blues have been getting state-backed breaks in taxes and hospital costs. Notwithstanding these, the Blues' situation was becoming untenable, with a massive rate hike considered the alternative to the legislation that passed.

Although there was debate over how large the effect would be, there was general agreement that private insurance rates would tend to rise. Insurers claimed large increases would be likely. For example, a Prudential spokesperson predicted rate increases for 70% of its small business customers with the average rate increase in the 20-50% range. Proponents of the legislation pointed to the ability of insurance regulators to control these increases.

After the legislation passed, there was not a mass announcement of companies pulling out of the state. This was good news for the availability of coverage but bad news for costs to consumers. It suggests the companies believe they will be able to pass along higher costs. If so, the legislation will work as a cross-subsidy, making health insurance more available and cheaper for higher risk customers but more expensive for lower risk customers, just as community rating works for auto coverage. The higher costs will unquestionably cause at least one employer to drop health insurance and others to reduce coverage by devices like benefit caps, higher deductibles, more copayments, and larger employee contributions. There is no way to estimate reliably the magnitude of these effects.

State Health Notes (7/13) considers **Maine**, **Oregon**, and **Vermont** the only other states with community rating, "though their laws are less far-reaching than New York's." With most of the legislatures not now in session, the state with the most lively prospects for further 1992 action is **Ohio**, where substantially different House and Senate bills are now in conference committee.

The contrasts between sweeping plans to extend health care coverage and modest changes in existing insurance arrangements are most obvious in **California**. Many varieties of universal care have been offered in the legislature. The California Medical Association has been pushing a ballot initiative to mandate employer coverage. Governor Wilson opposes these in light of the state's economic problems: "The last thing in the world we need to do to small business in California is add to their cost burdens."

His proposals include pooling small business insurance purchasing power, limited regulation of rates charged employers with between five and 25 workers, limiting insurers' ability to delay coverage for pre-existing illness and to refuse to renew policies, covering workers who change employers, changing prohibitions against corporate practice of medicine to let hospitals employ doctors, creating a uniform billing form for all insurers, and preventing physician conflict of interest in referrals of patients to testing and other facilities in which physicians have ownership interests. The elected California insurance commissioner, who has a more extensive proposal of his own, calls the governor's plan "lowest-common denominator politics," and "creeping incrementalism." He argues it "offers Band-Aids when our health care system needs major surgery."

State subsidies for private coverage are proving unpopular. To avoid having the plans to provide new or cheaper private coverage become zero-sum games among premium payors, states must bring new money to the table in the form of subsidies of private coverage either through direct expenditures or tax expenditures. New plans to do this anytime soon didn't go far this year. **Florida**, **Minnesota**, and **Vermont** have enactments with scheduled future implementation. New proposals involving use of state resources are constantly appearing. For example an **Idaho** task force on the uninsured recently reported with recommendations for expanding Medicaid and tax incentives for employer plans.

The Florida, Minnesota, and Vermont plans are mostly plans to make plans, not plans to do something specific. As the Burlington Free Press (2/9) commented on Vermont's plan, "There will be skirmishes at every crossroads ... as the health care authority begins to design the universal access plan." The Boston Globe (7/6) described the plan in glowing terms -- "the most far-reaching health reform legislation ever enacted by any state" -- but followed with the words that become the death knell of reform plans covering taxes, school finance, insurance, and health care: "**The details have yet to be worked out.**" USA Today (5/13) said the Vermont law "does little more than promise to do something in the future." The Minneapolis Star-Triune (5/17) counts Minnesota's new HealthRight plan as creating 13 commissions, boards, task forces and committees, requiring the hiring of 116 staff personnel, like analysts and auditors, and calling for 33 studies and reports.

Past enactments aren't fairing well. **California** continues to postpone its tax credit for employers newly providing coverage. The much touted **Massachusetts** universal plan of 1988 isn't dead, but its "pay or play" requirement now is deferred until 1995. The Bay State had several transition demonstration programs with state subsidies of private coverage for hard-to-cover groups. They were terminated in April. **Georgia**'s pool concept (enacted in 1989) was based on agreement on the rate ceiling of a maximum of 50% above base rates, but no agreement on how to pay the excess. Hospitals balked at a surcharge on hospital stays. Insurers balked at a surcharge on premiums. The governor and key legislators balked at a state subsidy. So the plan hasn't been implemented.

The alternative to states bringing new money to the table is to take some benefits off the table. Many of the reforms do just this by exempting small employers from past state mandates of coverage, such as for mental health. **Florida**'s new legislation is one of many examples. As of April, the "basic benefit plans" were being marketed in 10 states: **Illinois**, **Kentucky**, **Maryland**, **Missouri**, **Montana**, **Oklahoma**, **Oregon**, **Rhode Island**, **Virginia**, and **Washington**.

The state reforms are showing limited results, but the situation could change. A recent General Accounting Office report (Access To Health Insurance: State Efforts to Assist Small Business) summarized the situation:

> *Because of the difficulties in marketing new insurance policies to small firms and because most of the reforms have been introduced during the recession, it is too soon to tell whether the reforms will increase insurance coverage. Budget problems are limiting states' ability to adopt reform measures requiring substantial state subsidies or funding. As a result, states are tending to focus on reforms involving little or no cost to the state treasury. These reforms attempt to correct several serious problems in the market but have yet to significantly increase the number of small business employees with health insurance.*
>
> *Initiatives requiring state subsidization of the small business market are rarer, tend to be limited in scope and duration, and have produced limited results. Attempts to lower the cost of insurance by waiving state-mandated benefits have also produced only modest employer responses. Ultimately, small business market reforms may do little to make health insurance more affordable because they do not address the underlying growth in health costs.*

MEDICAID CUTS ARE HARD TO FIND

Cost-Cutting Options: Through all of the budget-tightening of 1992, there have been few real cuts in Medicaid programs. To save big money in Medicaid, states would need to do one or more of the following: (1) cut the number of people eligible for services, (2) cut the list of available services, (3) cut the prices paid per unit of service, (the reimbursement rates), (4) effectively steer patients from high cost to low cost services and/or from high cost to low cost providers, and (5) require Medicaid recipients to pay more for the services they receive, (copayment).

Eligibility Restrictions: Eligibility for Medicaid is largely controlled by eligibility for cash assistance programs, like AFDC, and by federal mandates increasing eligibility for pregnant women and young children. The tendency in cash assistance programs has been to freeze payment levels, but not to reduce the standard of need that determines eligibility. The state medically indigent programs, for those not on cash assistance programs, have generally survived through a combination of perceived federal mandates and fear that restricting eligibility will just substitute costs without federal cost sharing (e.g., indigent care, hospital bad debt) for the same costs now being shared with the federal government.

Proposals for eligibility restrictions affecting nursing home recipients under medically needy programs have met with massive reluctance. No one wants to kick current residents out of their nursing homes. One such plan, in Governor Weld's cost-cutting recommendations for **Massachusetts**, now has been dropped. Governor Thompson dropped a proposal to extend **Wisconsin**'s cost-cutting plan to home health care. **Oklahoma** dropped proposed eligibility restrictions this spring in face of a threat that 6,000 nursing home residents would be thrown into the streets.

> *It's elbowing out almost everything else in terms of growth. This is the gorilla that's out there. This is the Pac-Man, eating everything up. Wisconsin's social service secretary on the impacts of Medicaid, (Milwaukee Journal, 3/15)*

Texas officials decided to absorb the scheduled eligibility increases (to 185% of the poverty level) for pregnant women and infants ahead of the schedule required by federal mandates. In a reverse move, **Idaho** decided to drop some previously planned expansions of eligibility for the medially indigent. In **California**, the governor's early-July proposals to resolve the budget crisis included limiting Medi-Cal eligibility to legal aliens and citizens, eliminating substantial costs for illegal aliens.

One area of restricting eligibility showing intense activity is the prevention of higher income elderly persons from impoverishing themselves to become eligible for Medicaid. These proposals are part of a newly announced governor's plan in **Ohio** and have been adopted in one of many available forms by an uncounted but substantial number of states.

Service Reductions: A major barrier to eliminating coverage of optional services is that many states don't provide them now. The most activity appears to be in cutting optional services in states that have them, such as certain forms of dental and optical care. The governor's mid-June proposal would drop many of California's optional services including acupuncture, dental care, chiropractic services, podiatry, and psychological counseling.

Rate Cuts: There have been two massive institutional barriers to cutting reimbursement rates: (1) fear of litigation under the Boren Amendment and (2) desires to make deals with providers swapping higher reimbursements for support of provider taxes.

Medicaid rates are often well below private and Medicare rates. This raises concerns that at current rates most services will become unavailable in rural areas and prenatal care may become unavailable anywhere. Where reimbursement rate changes are occurring, they aren't necessarily cost-saving measures. For example, **Texas** has been emphasizing preventive care by lowering rates for anesthesiology and radiology, but raising rates for primary care physicians.

Shifts To Lower Cost Providers Or Services: Nearly every state is discussing the cost-cutting potentials of: (1) diverting potential nursing home patients to home health care, (2) diverting routine cases from emergency rooms to physicians' offices, and (3) managed care. However, budget officials have been reluctant to count savings from these measures, as each contains significant potential to increase costs by greater utilization.

Copayments: The concept of copayments being made by people who, by definition, lack the ability to pay has never been an easy sell to legislators. The new copayments are generally too small (e.g., a dollar per physician visit) to have much of an impact on bottom line Medicaid spending. Nominal copayments aren't popular with providers. The cost of collecting and accounting for them can exceed the value of the copayment. It is also realistic to expect that the providers themselves will make many of the copayments theoretically being required of Medicaid recipients.

Phony Savings: The most popular claims for cost cutting in Medicaid aren't cost cuts at all. Continuing past practice, many states are appropriating less than the predicted costs of current services and calling the difference savings. These are likely to appear as supplemental appropriations later in the year. The rationale for the reductions takes forms like requiring unspecified savings to be realized by later administrative action and/or by better management.

Popular Ways to INCREASE Medicaid Costs: Medicaid budgets, but not necessarily total state and local indigent health spending, are being increased by decisions to move large numbers of people out of 100% state and local indigent care programs and onto Medicaid to gain the advantage of federal cost sharing. Examples are special programs for general assistance recipients, state-funded subsidies for indigent care that serve some persons who could be qualified for Medicaid, public health programs, activities in state facilities for the mentally retarded, and substance abuse programs.

Organizations of state officials aren't discouraging such activities, though they increase Medicaid spending. For example, in May the National Governors' Association released a report, Outstationing Medicaid Eligibility Workers At The Community And Migrant Health Centers. "Outstationed" eligibility workers are to the number of Medicaid recipients the equivalent of what "Avon-calling" personnel are to cosmetic sales.

Because provider tax revenues are typically off-budget, raising provider taxes cuts on-budget spending increases. This effect has been explicitly claimed as savings and budget cuts in some states, such as **New York**.

Most states are looking to ways to expand Medicaid to cover 100% state-financed costs and to cut Medicaid fiscal impacts by provider levies rather than looking for ways to cut Medicaid outlays. The result is a substantial state bet that federal policy will not be changed soon. The stakes are high, accounting for a large portion of the $10 billion federal supplemental appropriation needed in the federal FY 1992 budget for Medicaid.

The state stakes in current federal Medicaid policy are becoming larger by the day. Many state officials worry about the prospects, even as they expand their reliance on the program. The Maine Telegram (2/9) captured many of the worries in a feature entitled, "Medicaid: A 'House of Cards'." The head of the mental retardation agency, who now gets 40% of his funding from Medicaid, called the situation "a mixed blessing" because "your vulnerability continually increases as you draw down more federal dollars." A deputy in the Maine human service agency called plans to expand Medicaid "reasonable and sound," but continued:

> *I'm not confident that anything in the federal budget is safe. If they pull the rug out from under Medicaid, you're going to have 50 states filling for Chapter 11 bankruptcy protection.*

An exception to the general reluctance to cut Medicaid may be **Wyoming**, at least according to April's State Health Notes. It indicates that the state: (1) limited inpatient hospital coverage to 20 days and physician visits per year to 12, (2) reduced drug coverage, and (3) instituted copayments of $1 per physician visit and $3 per outpatient hospital visit. However, these changes are expected to cover only about a third of the $27 million cut elected officials were seeking.

PROVIDER TAXES CATCHING ON

New provider taxes to finance Medicaid remain the hottest area of policy change in both health care financing and overall state tax policy. On other subjects -- both general tax increases and financing indigent care -- there is lots of talk and little action. On provider taxes, there is much action, but state officials are minimizing talk. Why? First, by any common sense understanding of the term, these are new *taxes* being levied by officials trying to run on the basis of not enacting new taxes. Second, the subject is understood by few policymakers and even fewer reporters.

Medicaid provider taxes, such as a gross receipts tax on hospitals, were adopted by a substantial number of states in 1991 and 1992, but by far fewer states than will eventually adopt them. Some of the states that are facing the mid-1993 deadline for eliminating provider donation financing haven't yet acted. **Illinois** was the latest state to act. It adopted over $700 million in provider taxes in July as part of the compromise FY 1993 budget. The governor told reluctant providers their alternatives were an unlikely income tax increase -- which he and a majority of legislators oppose -- or sharp cuts in Medicaid reimbursement rates. **Missouri** also recently adopted a hospital provider tax.

The reaction of provider groups to the provider tax proposals has been inconsistent both among different providers in the same state and the same providers in different states. **Reports** perceives provider support increasing for three reasons. First, decreasing time between the decision and the time existing donation and disproportionate care programs become invalid under current federal law. Second, increasing perceptions, where applicable, that state elected officials won't raise taxes, or that if they do the funds will be spent as promised on education, not health care. And third, increasing willingness by state officials to cut deals with providers involving other issues, particularly reimbursement rates.

Providers have been opposing, and are likely to continue to oppose, provider taxes when the revenues would be used for new initiatives in health care. Financing new services is less popular than paying for the increased costs of the Medicaid services already provided, with each provider group's share of the taxes roughly equal to each group's share of Medicaid spending. The governor's proposal in **Delaware**, as announced in June, is an example of a new tax associated with new spending that was being opposed by providers.

However, the new **Minnesota** HealthRight plan extends health insurance coverage to uninsured households not eligible for Medicaid. This is financed with both a cigarette tax increase and a 2% tax on gross provider revenues. The state's hospital and doctor associations objected to the provider taxes and urged higher income taxes to pay for the plan, but couldn't convince the governor or legislature. They could be back to fight another day. The hospital taxes aren't effective until 1993. The other major provider taxes don't take effect until 1994. A 1% tax on health insurance premiums and health maintenance organizations isn't slated to be in effect until 1996. Providers weren't losers from the package. It contains Medicaid rate increases such as 20% for outpatient hospital care and 25% for physicians.

In **Arkansas**, the Coalition for a Healthier Arkansas is seeking to enact a $0.25 cigarette tax increase with support of the hospital association, which likes the measure as an alternative to provider taxes.

Federal Policy Still In Doubt: Uncertainty remains over provider taxes as the federal government hasn't yet implemented the regulations to implement last year's legislation. When 14 governors visited with Bush Administration officials in June, they were told by the Health and Human Services Department deputy secretary, "The only thing more important than getting the regulations out quickly is getting them out in good shape."

> *One argument for adoption of a compromise {the 1991 law) as opposed to a moratorium was that the governors wanted some certainty in the law so that they could make decisions. But the proposal that was adopted was flawed in that it did not give the certainty, the guidance, needed to pin this issue (provider assessments) down and put it behind us. -- U.S. Representative Waxman, quoted in State Health Notes, (3/23).*

GAMBLING AND LOTTERIES

The Spread Of Legalized Gambling: Legal gambling is now easily accessible to nearly every American. By one count, some form is already available in every state but Hawaii and Utah. In many of the states that have been the slowest to move to modern legalized gambling, charity Bingo and casino nights are widespread.

As more states have adopted lotteries, racing, and other forms of gambling, it is increasingly clear that state prohibitions are not preventing state residents from gambling. Stories of lottery pools to invest in tickets of other states, bus charters to Atlantic City casinos and neighboring-state race tracks, and massive sales in tiny stores just across the border into a lottery neighbor of a non-lottery state are common. All strengthen the case that state access to gambling jobs and state revenue, not residents' access to gambling, is being restricted by gambling prohibitions. Public opinion polls and voter approval of gambling in other states is convincing reluctant elected officials of public support.

> *But like a high-roller on a hot streak, most states aren't worried about the long run. The fever has taken hold, and the promise of quick payoffs is still too tempting to pass up. To the voices of caution, the gamblers' answer is "let it ride." -- Gambling Fever: Odds Are, You've Got It, Midwestern Legislative Conference Of The Council of State Governments (1992).*

Changing Opposition To Gambling: Some state officials and religious groups have tried to buck the trend or at least slow the rush. There appears to have been a change in the source of opposition to new legalized gambling proposals. The importance of moral objections has shrunk considerably to a few bastions -- the Mormon church in the West and Christian fundamentalists in the South. Now the strongest opposition to extension of legalized gambling comes from beneficiaries of old legalized gambling fearful of new competition.

Some of this opposition is formidable because it brackets the sources of influence in state policymaking. On the one hand are groups clearly representing large numbers of ordinary citizens -- religious groups, volunteer fire departments, and other bastions of the community. On the other are the already legalized operators, such as race track owners, with their strengths in the behind-the-scenes atmosphere of campaign finance, as well as lobbyists who are established figures in their state capitols.

Gambling Appears Secure: It is conceivable that some event would turn back the current trends, but it is hard to imagine what it might be. So many people have vested interests in the continuation and expansion of present legalized forms of gambling that it is most unlikely that the feared corruption of legalized gambling, even if it materialized in several states at once, would cause abandonment of gambling any more than evidence of corruption in Medicaid has caused its abandonment.

Lotteries Becoming Mature: With the Texas lottery now underway and Georgia and Nebraska voters likely to approve lotteries in November, 37 states, including all the major industrial states, will be in the lottery business. Some of the Northeastern lotteries are now over 20 years old, meaning that a whole generation has come of age without any recollection of periods without lotteries. Only a few of the major lotteries are so recently established that their sales are subject to both the stimulus of start-up excitement and the lower per capita sales associated with start-up processes. Except for states which established lotteries in 1989 or later (* in the table below) per capita sales reflect long-term differences among states.

Per Capita Lottery Sales, CY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Massachusetts	$267	13	Delaware	$107	23	Colorado	$64
2	South Dakota	198		**United States**	**109**	24	California	61
3	Maryland	169	14	Kentucky*	95	25	Washington	59
4	Florida	167	15	New Hampshire	87	26	Arizona	56
5	New Jersey	165	16	Wisconsin	85	27	Iowa	56
6	Connecticut	163	17	Vermont	83	28	Idaho*	50
7	Ohio	151	18	Maine	81	29	West Virginia	47
8	Illinois	140	19	Indiana*	75	30	Missouri	42
9	Virginia	133	20	Oregon	69	31	Louisiana*	38
10	Michigan	124	21	Rhode Island	66	32	Kansas	31
11	Pennsylvania	122	22	Minnesota*	65	33	Montana	31
12	New York	113						

The disparities in per capita lottery play are substantial, with the Massachusetts total more than twice the national average. Six states are at half or less of that average. Many explanations are possible for the differences. They include factors under the control of state governments such as the variety of games available, the restraints states place on advertising, the percentage of revenues available for prizes, the prize structure (mix of small and large prizes), the size of the state (and thus the size of typical jackpots), and the skill of each state's lottery administrators. Other variables relate to the state's demographics. Some population groups bet more than others. States are unequally endowed with those populations. Finally, there are competitive factors beyond state control, such as whether neighboring states have lotteries.

Lottery Sales Growth: Over the past year, state lottery sales have grown by only 0.5%. When adjusted for the number of persons in lottery states, revenues shrank by half a percent as shown in the table.

Percentage Change In Lottery Sales, CY 1990 - CY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Kentucky*	81.9%	13	Delaware	1.6%	23	Michigan	-2.9%
2	South Dakota	45.2	14	Illinois	1.6	24	Missouri	-3.3
3	Oregon	29.0	15	New Hampshire	0.5	25	Pennsylvania	-5.2
4	Colorado	27.3	16	Connecticut	0.2	26	Montana	-5.3
5	Virginia	26.5	17	Vermont	0.2	27	Florida	-5.4
6	Minnesota*	16.2	18	Maine	0	28	Idaho*	-7.3
7	Washington	14.4	19	Rhode Island	0	29	Iowa	-9.1
8	Kansas	12.6		**United States**	**-0.5**	30	Indiana*	-9.9
9	West Virginia	11.6	20	Ohio	-1.3	31	California	-20.7
10	Wisconsin	11.0	21	Maryland	-1.8	32	Arizona	-29.6
11	Massachusetts	2.9	22	New York	-1.9	33	Louisiana*	N/A
12	New Jersey	2.7						

While there is great variation among states (which **Reports** cannot explain), the budget message for the large industrial states is that lottery revenues didn't exhibit significant growth, and actually declined in many. The 1991 results are the first serious demonstration that state lotteries are not a powerful revenue engine that can be counted on to grow by at least the rate of inflation in good times and bad. The recession apparently had effects on the purchase of lottery tickets similar to its effects on other consumer purchases. Even in better economic times, the large-state lotteries have been unable to maintain the rapid growth of their early years. For example, declining lottery revenues for schools in **California** have strengthened the resolve of education interests to fight for the constitutionally guaranteed share of state revenues under Proposition 98.

Earmarking Lottery Revenues: The lack of growth in lottery revenues and the instability suggested by large gains and losses among individual states is not much of an argument against having lotteries. It is a substantial argument against earmarking lottery revenues for a stream of expenditures that exhibits a steady profile of growth. The resulting problems have been particularly severe in **Pennsylvania**. Most states earmark money for education. But Pennsylvania's earmarking is for programs for the elderly, particularly subsidizing the purchase of prescription drugs. As these costs have grown in some years much faster than lottery revenues, Pennsylvania decisionmakers have been confronted with the awkward choice of scaling back spending or financing a portion from general revenues.

Other Gambling Forms Advance: The states now appear to be moving quickly into new forms of gambling such as video poker (called video lottery terminals) and casino gambling in special situations -- ships to nowhere, riverboats, and historical towns. **Colorado** and **South Dakota** both have historical towns which are currently operating casinos. **Illinois**, **Iowa**, **Louisiana**, and **Mississippi** have all approved riverboat gambling. **Missouri** voters will consider riverboats in November. Gambling on Indian reservations is providing an impetus to gambling in some states, sometimes in peculiar and unpredictable ways (see box).

Many want their states to be among the leaders in the latest gaming innovation. This year the **Louisiana** legislature authorized a casino in New Orleans. Temporary tables could be in operation as early as next spring. However, there will be litigation over whether the action conflicts with a state constitutional provision: "Gambling shall be defined by and suppressed by the legislature." Chicago business and government leaders are asking the **Illinois** legislature to adopt a multiple-casino plan for the Windy City. There are similar proposals for Cleveland, Detroit, Hartford, Milwaukee, and other large cities.

Indian Gambling, The Wild Card

The complex ground rules for gambling on reservations boil down to the concept that states cannot prohibit tribes from offering gambling opportunities that are legal anywhere in the state. The interaction of this rule with charity gambling statutes, the wording of lottery amendments in individual states, and conflicting interpretations of federal rules and state laws has created near chaos in some states.

Governors and legislatures are frequently getting crosswise on the issue, as has happened in Connecticut and Kansas. The situation in Wisconsin is so complex that it defies explanation in anything short of a book-length treatise. The speaker (D) offered the governor (R) an oblique compliment by commenting, "This is the only issue he has managed to totally screw up in his 5 1/2 years as governor." The Wisconsin Taxpayers Alliance recently suggested that as a result of the decision to put a five-question advisory referendum on the April ballot, "Come April 1993, the gambling waters might be even muddier than now."

Iowa is offering "lottery" tickets in vending machines that let the purchasers buy paper tickets and pull off ticket coverings with the same results as pulling a slot machine lever -- matching fruits and other symbols for prizes. Other pull-tab games simulate blackjack and poker. The ads say, "CASINO ACTION! As close as you can get without being there."

Video lottery machines -- video terminal versions of slot machines, computerized poker, and bingo -- have been approved in at least five states. Other states are seeking to match **South Dakota**'s success. Its revenues of $46 million in 1991 equaled the costs of its prisons and courts.

> *There is little difference between a video lottery terminal and the basic video poker or blackjack unit. Take one of the video pokers found in any Nevada or Atlantic City casino, change the glass, replace the coin hopper with a ticket printer and presto, you have a VLT. It is not much of a change but it makes all the difference to those who oppose "casino gambling" but do not feel nearly as uncomfortable with lotteries. -- Gambling & Wagering Business (12/15 1991)*

Sports betting has been approved in **Delaware** and **Oregon** in addition to **Nevada** which has allowed it for decades. The National Football League is so alarmed by the trend it is asking the Congress to outlaw the practice.

The bounds of ways to legalize gambling are tested by a tongue-in-cheek proposal in New England to take the controversial Seawolf submarine and convert it to underwater gambling, one-upping the riverboats of the Midwest. As one proponent puts it, "Far from being above the law, participants will now remain safely below it."

Gambling Economics: The state gambling proposals have produced extreme claims of economic benefits. A technical note applying conventional analytic techniques appears at the end of this issue. The different claims were recently exhibited in **Louisiana** with vast differences between opponents and proponents, and even among proponents, in predicted economic impacts of a new casino. Ironically, the site is a convention center area available because optimistic claims for it haven't been realized. Recent separate **Illinois** studies credited $1.4 billion in economic activity to horse racing and credited the proposed Chicago casinos with a $3.7 billion impact. The state and local tax impact was estimated at 5.7% of total impact in the horse racing study and 14% in the casino study.

The continuing caveat on all claims for extraordinary returns from legalized gambling is that competition among states and among forms of gambling will tend to reduce returns over time. Examples: the national movement to cut state taxes on horse and dog racing, pressures to reduce the state percentage from lotteries, and moves to end limits on riverboat gambling in **Iowa** because of **Illinois** competition.

FISCAL UPDATE

Calm Before The Storm

The months of July through November are usually quiet periods in state fiscal decisionmaking, particularly in election years. This year is no exception in most states. Legislatures aren't in session. Leading elected officials are worrying about national party conventions and the fall campaigns. Staff members are going to their annual conventions and taking vacations. Information that is the grist for the fiscal mills -- new economic forecasts, monthly revenue performance reports, indications of agency needs for supplemental appropriations -- are accumulating in many in-boxes.

In many states, as State Budget & Tax News has been suggesting in reviewing the results of the 1992 legislative sessions, the news accumulating in these in-boxes isn't good. Reasons: (1) national, and thus state, economic performance hasn't been exciting, (2) some of the assumed savings in FY 1993 budgets, particularly in Medicaid and state payroll costs, aren't being realized, and (3) many FY 1993 budgets left problems for FY 1994 by use of one-time revenues, deferral of costs, and drawing down surpluses. Staff members will find the predictable results in their in-boxes before November, but incumbent elected officials have no motivation to find problems yet.

California's Problems Won't Quit

Stalemate Continues: The big exception in the otherwise quiet summer is **California.** It has been getting national publicity for not passing a budget for the fiscal year that began in July and paying state bills with IOUs (registered warrants) to handle cash shortages. Bond ratings have already dropped and could drop again if the situation isn't resolved by actions that bond rating agencies deem to be tenable long-term fiscal policies.

California's procedures require a two-thirds vote to pass a budget, so both parties in each House must be involved in any resolution. Republican legislative leaders and the governor are holding the position simply expressed by their Senate leader, "We're in a non-negotiable mode when it comes to deficit spending ... and we're not going to encounter taxes." This posture concentrates all of the $11 billion in budget balancing believed to be needed on spending reductions. The Democrats are amenable to some spending reductions, but not as large as the Republicans seem willing to support. The gap is symbolized by the difference between a $2 billion education cut discussed by some Republicans and the $605 million cut presented to the governor and vetoed.

Emphasis On Blame Shifting: The level of partisan name-calling between the legislative leaders (D) and Governor Wilson (R) remains higher than in many states.

The governor blames the impasse on the Democrats, who blame him. They have called for future deliberations to be in open meetings so the public can decide who is being intransigent.

The governor told the press that he would rather tolerate the "chaos" from lack of resolution of the issues than "take this terrible misstep from which I think the state would never recover." That "misstep" is adopting "ruinous deficit spending as a matter of policy." He argues, "If that's allowed to happen, it will set the stage for massive, regular increases in your state taxes -- especially in your income taxes -- every year for the rest of the 1990s." The governor's communications director slammed a legislative budget proposal as a "Democratic wish list," missing only "aid to the Viet Cong."

Democrats attacked the governor from many directions. One was that he was abdicating his leadership role. Another was that he was contributing to the deadlock to improve the November election prospects of both Republicans running against incumbent Democrats and of his ballot initiative that cuts welfare and gives him new powers over the budget. Legislators of both parties do agree that continuing stalemate will make all of them look bad to the public. The speaker's comment on the governor's strategy was, "Who knows what he's thinking, if he's thinking at all."

The Fiscal Problem: While California's economic and fiscal problems are a disaster by California standards, they aren't as serious as those of some other states. In both personal income and employment changes (see Issue 12), the California economy has been performing better than the economies of **Connecticut**, **Massachusetts**, **New Hampshire**, **New York**, and **Rhode Island**. Partly because of tax increases adopted in 1991, the state's FY 1992 revenues were up about 5.2% from FY 1991. This was a respectable increase in relation to inflation and population growth.

So why is California now in so much more trouble than the economically worse-off Northeastern states? One reason is timing. Recession hit the Northeast late in the 1980s. Many fiscal adjustments, including tax hikes well above California's 1991 increases and spending austerity, have already been made. Second, expectations were higher in California. The 5.2% FY 1992 revenue increase experience in California would be news in the Northeast, but not compared with a 13.5% increase assumed for California as recently as when the governor filed his budget in January. Third, demographic trends are unfavorable. California is adding nearly 300,000 school students a year while Northeastern enrollment is stagnant. New migrants continue to pour into California, often not finding jobs but adding fiscal pressures in health and social services. Fourth, California has had a run of bad luck with fires, riots, and earthquakes.

A Preview Of Retrenchment Strategies: California officials were close to budget agreement by the June 30 deadline. Positions at that time and proposals since suggest that California's spending adjustments will look much like those of the Northeastern states:

Public schools won't get increased state aid meeting the two tests of Proposition 98: (1) matching the combination of inflation and student count increases or (2) maintaining a constant share of the state budget.

Higher education will take disproportionate hits to be covered in part by tuition increases (still leaving California tuition below most states) and in part by a reduction from current service levels. Community colleges, now protected by Proposition 98 along with public schools, will share in austerity.

Welfare grants won't grow automatically anymore, a decision already made, and may well be cut from levels well in excess of other states.

Local governments will be forced to share the state's pain, at least proportionately.

In relation to other states with underlying economic problems, California's revenue system has several features that seem likely to be reconsidered if fiscal problems continue. The first is indexing of the income tax to keep inflation from shoving taxpayers into higher tax brackets. Indexing also keeps growth in revenues from the graduated income tax from growing as rapidly as in other states. The second is the absence of provider taxes and the aggressive exploitation of Medicaid funding that has characterized the fiscal management of other states with economic problems, particularly **Massachusetts**, **New Hampshire**, and **Rhode Island**. The third is a generous public employee pension plan that is well funded, suggesting reducing costs by reduced benefits for new state and local employees (not being discussed) and simply lowering employer contributions to the present plan. The second choice is serious enough so that employee groups are banking an initiative to prevent it.

Issues Resolved In Other States

Greased by better-than-expected FY 1992 revenues, **Massachusetts** deliberations moved smoothly to a conclusion even though the process extended beyond July 1. Interim budgets were adopted without major controversy. The overall budget reflects a compromise between the Democratic legislative majorities and Governor Weld (R). The governor's proposed business tax incentives are dropped, but a phased-in estate tax reduction which he also endorsed is included.

Officials of many other states long ago finished their budgets and left the state capitols. In **Florida**, fiscal problems were patched enough so that incumbents will generally be able to return next year to resume the battle. Provider taxes were the linchpin of a similar resolution of issues in **Illinois**.

Looking Ahead To Fiscal Problems And Tax Increases

Recently a subscriber asked in which states the pressures were strongest for big fiscal decisions, including possible tax increases, to be made immediately after the November elections or early in the 1993 sessions. The answer was guesswork, of course. For what it's worth the list is: (1) the states (**California**, **Illinois**, and **Rhode Island**) with difficulties in enacting a budget by July 1, to the extent they don't resolve their problems earlier, (2) two states with gaping self-inflicted wounds, **Texas** with an unconstitutional property tax system and **Oregon** with its new property tax rollbacks, and (3) **Alabama**, **Florida**, **Louisiana**, **Michigan**, **Ohio**, **New Hampshire**, **New Jersey**, **New York**, and **Tennessee**. Other states have problems, but are less likely to have to resolve them before completing their normal budgeting process for FY 1994.

Action and inaction by the **New York** legislature before completing its session in July are indicative of issues to come. The legislature passed a status quo budget more or less on time. But it didn't act on two subjects that were the cornerstones of the governor's plan for state action to encourage economic development: (1) a bond issue that would have gone to voters in November and (2) new authority for the toll highway agency to sponsor development projects.

Empire State legislators also left several local fiscal problems unresolved. The first was the uneven and large impact of required local government cost-sharing for Medicaid. The second was coming to grips with the fiscal problems of two Long Island counties which together serve nearly as many people as most states. Nassau and Suffolk county officials have done as much budget cutting as they want to do, so they now see the alternatives as unacceptable tax increases (e.g., a 25-30% increase in property taxes) or authority from the legislature to borrow to cover operating deficits and to cover debt service by less dramatic tax increases -- a half-cent sales tax increase in Suffolk and taking a 1% cut of the amount of newly recorded mortgages in Nassau County.

HIGHER EDUCATION TAKING BIG HITS

One of the realities we have to face is that there are programs we'll never be able to go back to. ... We'll never again have the great free-tuition university system that we once knew. -- Bob White, Governor's chief of staff, California

As the **California** budget gap reached $11 billion out of a budget of $60 billion, previously unthinkable cuts bec~~ome serio~~us alternatives. One is a 15% cut in state support of universities -- more than can be handled by tuition without severe dislocations for the many students who have built education plans around tuition at or near present levels.

Even before final budget approval, the grim outlook, an 8% cut in the optimistic scenario, was forcing decisions. Four campuses announced they won't accept applications for admission this winter or next spring. About 30,000 students, including community college transfer students, will be affected by the action. The number is expected to multiply as other state institutions copy the move.

In **Ohio**, the governor made administrative cuts in July to cover expected shortfalls in the newly enacted budget. Higher education's share of the cuts was much larger than its share of the budget. Buckeye State universities and community colleges took disproportionate hits earlier, absorbing 39% of the February 1991 cuts and 29% of the December 1991 cuts. Higher education officials calculate that per-student support has dropped from $5,000 four years ago to about $4,000. Recently approved 9% tuition hikes will cover about half the most recent cut. In **Minnesota**, the oft-threatened, little-implemented step of closing a state institution is occurring. This summer the University of Minnesota at Waseca will become history.

In **Oregon**, the governor's proposal to institute a sales tax to cover losses from a voter-approved cutback of property taxes failed. The higher education community, while hoping for a reversal in the legislature, is now planning for a 20% cut in state support for the biennium that begins next year. In **New Jersey**, the funding for state colleges has been dropped to 1988 levels. The budget includes a $30 million fund earmarked for institutions that don't raise tuition by more than 4.5%. Trenton State trustees raised tuition by $105 or 4.45% but added a $500 "fee for quality."

Nationwide, the salary survey of the American Association of University Professors shows this year's faculty salaries up 2.9% at public institutions. This contrasts with about 5% at private institutions. The chairman of the AAUP committee that ran the survey concluded, "The boom days of the mid-1980s are gone."

Do these illustrations, coupled with the generally poor success of higher education in competing for FY 1993 state money, portend really rough times ahead for public universities? It is too early to tell. This may just be a repetition of a pattern by which higher education becomes a "balance wheel" of state budgeting -- absorbing disproportionate cuts in bad times but doing relatively well in good ones. The cuts being discussed in California and Ohio may just be paving the way for the tax increases being sought by the governor in Ohio and legislative leaders in California. On the other hand, the California actions may force the state into a permanent adjustment toward the policies of Michigan and the New England states. They seek to maintain quality by abandoning a low tuition strategy, but to maintain access by generous student aid. What's happening won't be clear until economic recovery is well underway.

NOTE: THE ECONOMIC EFFECTS OF GAMBLING

Many of the proponents' and opponents' assertions about the economic and budgetary effects of gambling so conflict with widely accepted conventional economic wisdom that they would be marked wrong in most public finance courses. The effects are, by conventional wisdom:

Effect On The Economy: Lotteries and other gambling are objects of consumer spending analogous to theater admissions, health care, or soap. The spending is appropriately measured net of cash rebates, whether 50% (lotteries), around 1% (soap), or 0% (health care). Because such *net consumption spending* doesn't add to consumers' resources (except indirectly in all three cases), an expansion of lottery purchases will come at the expense of other purchases. Exception: in isolated cases, as likely in housing or health care as lotteries, spending might reduce savings rates. The net consumer spending pays two basic components: (1) *costs of production* (including profits) and (2) a *government take* which is economically the same whether viewed as: (a) the state share, (b) lottery "profits," (c) a tax, (d) fees, or (e) combinations of these.

Economic Feedback From Production Costs: The immediate (first round) effect of spending that goes to cost of production is to pay some people involved (e.g., clerks selling tickets, state inspectors) and to purchase some goods and services (e.g., tickets, ticket machines, advertising time). Both result in more employment, payrolls, and purchases. So added spending on lotteries -- a new state, new games, increased sales -- unquestionably creates jobs. Added spending on soap or health care also unquestionably creates jobs. But because the consumption spending total is fixed, **more gambling doesn't add net jobs to the economy**. Neither does more soap or health care. The net effect of, for example, a new lottery on an economy will be to add jobs in gambling and subtract jobs in whatever fields the consumers would otherwise have favored. A good working assumption is that the losses and gains will be about equal.

Purchases -- such as gambling, soap, or health care -- have different effects on economies of individual states and communities. The most favorable effects are felt when purchasing power comes from outside. Casinos do well by this criterion, along with other tourism and manufacturing. Lotteries don't do well. Also, the most favorable state and local effects are felt when the costs of production are incurred inside the local economy. From this perspective, purchases of manufactured goods, like soap and cars, are worst. Health care is best. Casino gambling is good because of its high local labor content compared with outside purchases of printed tickets, video and lottery terminals, and race horses.

Economic Feedback From The Government Take: The government take pulls the consumer's money out of the private economy, costing jobs and indirect tax revenues, but spends it in the public economy, creating jobs and indirect tax revenues.

The effects of the government take are comparable across goods and services. The magnitude varies. Considering taxes on producers and sales and "profits" like those of state-liquor stores and lotteries, the take is typically 35% of selling prices for lotteries, 20-40% for cigarettes, 6-12% for liquor, 4-7% for soap, and 0-1% for health care.

From a state and local perspective, the public sector effects are comparable to the private ones. To maximize favorable local effects, it is better to get the public take from outside the local economy (e. g., tourists and out-of-state lottery players) and spend it in the local economy (e.g., on teachers and retail clerks) rather than outside (e.g., purchasing police cars or paying interest). Because government spending, whether from lottery profits or sales and other taxes, cuts the money consumers have available for other spending, **state and local government spending doesn't typically create net new jobs**.

Subsequent Economic Effects: State decisions to tax and spend more or less, to spend on schools rather than highways or the reverse, and to acquire revenues from lotteries rather than property taxes make major differences to local firms and individuals. But these differences quickly wash out in their subsequent (second round) economic effects. For example, the spending patterns of a newly hired lottery worker are not greatly different from those of a newly hired retail clerk or nurse. Because these spending patterns aren't greatly different, their impacts on state and local revenues from added taxable sales, property values, and income aren't greatly different either.

In Summary: One can speculate at length and with some justification noting, for example, that casinos generally would have favorable effects, lotteries would likely be less effective than legalizing prostitution, but more effective than legalizing drugs unless the drugs are produced in the local economy. In general, **it is a good working assumption that standard forms of gambling are associated with job gains and with indirect tax revenue gains that are about equal to the job and tax losses from however the consumer would have spent the money newly spent on gambling.**

Assessing The Fairness Of The Government Take From Gambling: Assessing the range of government takes from gambling across gambling types and comparing those takes with takes on other consumption can provide policy-relevant insights.

Against a criterion of neutrality among alternative forms of consumption, gambling takes are clearly non-neutral. The highest take as a percentage of the amount bet is in lotteries, often 35%. This contrasts with some casino games where the take of government *and* the casino operator can be as low as 2% and generally is below 10%. But the casino gambler rebets most winnings within seconds. The horse race player rebets in increments of about 20 minutes. The lottery player often rebets in weekly or daily increments. So the government take percentage can be viewed quite differently if these time differences are considered, making the government take on casino gambling appear much larger.

Viewing the government take relative to the net spending of the consumer (amount bet minus typical return in winnings) the lottery take is extremely large. A two-dollar lottery ticket purchase typically produces a net consumer outlay of a dollar. Of this 70 cents is the government take and 30 cents is the cost of administration. By this criterion, casino bets also have a large government take relative to production costs while race track betting has a much smaller percentage. Because state officials have responded to concerns that horse racing has become non-economical and tracks might close, the government take percentage on racing in many states has probably fallen below the government take on consumer purchases of products like diapers, which are subject only to standard sales taxes.

The government take from gambling, whether by tax or "profits," can be analyzed relative to income groups just as tax policy is assessed for progressivity or regressivity. On that basis, lotteries are regressive. That is, their effect is to take government revenues that are a higher proportion of household incomes of the poor than of the more affluent. This fact (which lottery advocates sometimes attempt to refute) doesn't necessarily condemn lotteries in the eyes of state decisionmakers who view lottery purchases as voluntary and accept regressivity in other taxes, such as those on cigarettes and gasoline.

TECHNICAL NOTES

Health Care: The latest book on state options is Improving Access To Health Care: What Can The States Do? (John Goddeeris and Andrew Hogan, eds., Upjohn Institute, 1992). The book omits serious consideration of proposals oriented toward greater use of free market mechanisms to regulate costs, quality, and services. For that perspective, see publications of The Heritage Foundation (214 Massachusetts Ave. NE, Washington, DC 20002) like Why The Maryland Consumer Choice Health Plan Could Be A Model For Health Care Reform (June 1992) and Medicaid: Intergovernmental Trends And Options from The Advisory Commission on Intergovernmental Relations (800 K St., NW, Washington, DC 20575).

Federal officials are having trouble writing regulations on Medicaid matching definitions for understandable reasons. White House staff members have been intervening in individual state reimbursement cases, like New Jersey's, and don't want to get the Bush Administration in a posture of cutting health care for the poor just before elections. Federal OMB officials want to prevent 30% annual cost increases. The White House may want to extend its moratorium on new regulations. Adding to the federal problem: state officials are showing considerable ingenuity in defining taxes. As the CCH State Tax Guide (3/9) described the new West Virginia "Medicaid enhancement tax," the base is the portion of Medicaid reimbursements paid from state money and the tax rate is 100%.

Comparisons of per capita health care costs among states and statistical explanations for the differences were recently reported by the General Accounting Office (Washington, DC 20548) in Health Care Spending: Nonpolicy Factors Account For Most State Differences. The report contains numbers for 50 states -- Massachusetts is tops (1990) at $3,031 per capita, well above the U.S. average ($2,425), and even more above least expensive South Carolina ($1,689). Problems with the numbers abound. For example, the statistical base is 1982 data and costs of Vermont residents receiving care in Massachusetts hospitals are probably in the Massachusetts numbers, not Vermont's. Regression analysis based on the numbers tends to be either obvious (states with higher per capita incomes have higher per capita health care spending) or circular (the costs of health care rise when the ratio of physicians to people rises OR when health care spending is higher the physician-patient ratio rises).

Comparisons of Medicaid costs among states have a much stronger basis. Unpublished information on Medicaid cost variations previously discussed in **Reports** is now available in published form (Jane Little, "Lessons From Variations In State Medicaid Expenditures, "New England Economic Review, Jan./Feb.). The Employee Benefits Research Institute (2121 K St. NW, Washington, DC 20037) has a new 60-page summary of health care reform issues, Health Care Reform: Tradeoffs And Implications. The spring issue of Intergovernmental Perspective (Advisory Commission on Intergovernmental Relations, Washington, DC 20575) is devoted to intergovernmental health care issues, primarily Medicaid.

The conclusion that not much is happening in the states in major health care reform plans depends on **Reports**' consistent skepticism about state enactments involving no current spending or revenue loss but which promise benefits with heavy budget implications in future years. **Reports** discounts heavily scheduled tax cuts, the "temporary" in temporary taxes, scheduled future increases in state school aid, promised future health plans, and similar enactments. Without this skepticism, a case can be made that there is considerable activity in state health care reform. If proposals of commissions and governors are also counted, the case is even better. See, for example, the National Governors' Association press release (6/15) on health reform initiatives and the Governors' Bulletin (7/6), both touting actions in **Delaware, Florida, Hawaii, Minnesota, Montana, Oklahoma, South Dakota**, and **Vermont**.

Gambling: The tables on lotteries and the quotations, unless otherwise cited, are from Gambling & Wagering Business (4/15). A recent book, The Economic Consequences of State Lotteries (Mary Borg and others, Praeger, 1991) is clearly anti-lottery, but contains comprehensive citations to other economic assessments.

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STATE POLICY REPORTS

VOLUME 10 **ISSUE 15**

IN THIS ISSUE

State officials, reluctant to raise their own taxes, are skeptical about increasing local government aid and continuing past property tax relief programs. This and other factors have contributed to higher local property tax burdens, despite the public distaste for this tax.

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The state shift of financial pressures to local government may have a counterpart in shifts of federal responsibilities to states, bringing new ideas for state taxes to finance the shift.

- What Happens When Federal Policy Changes? p. 7

The big action in state tax policy remains provider taxes as states try to minimize the impact on general funds of growing health care costs.

- Health Care Update p. 10

All the shifts — federal to state/local, state to local, and state to health care providers — leave state and local finances in the worst shape in a decade, according to two new surveys.

- Fiscal Conditions Poor p. 12

If they were nations, most states would rank among the top 50 in the world. If companies, most would make the Fortune 500. A few local governments have larger budgets than many states.

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August 1992 (First Of Two August Issues)

RESURGENCE OF THE PROPERTY TAX

Property Taxes Rising

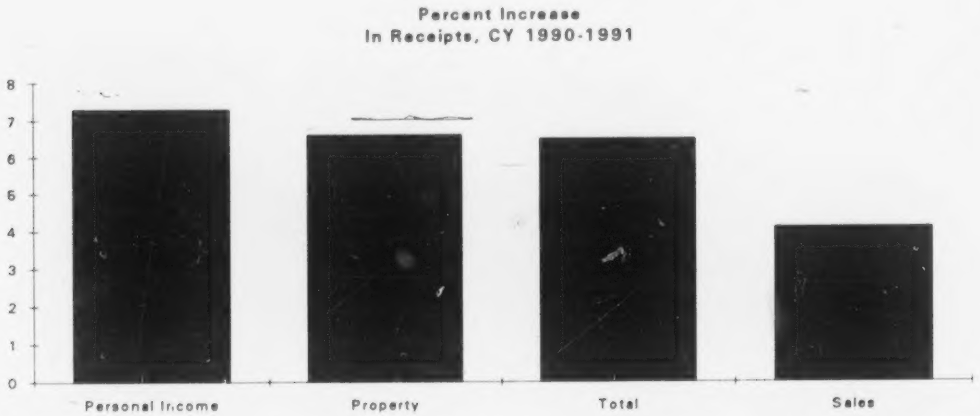
State and local reliance on property taxes and growing demands for services, particularly schools for baby-boomers, led to property taxes that took 4.77% of personal income in 1972. This large tax bite and public opinion polls indicating that voters like property taxes less than sales or income taxes led to many efforts to provide relief. They included sharply increased aid to local governments, particularly school districts, state-funded property tax relief measures, and tax limits such as Proposition 13 in **California**.

These policies and reduced pressure from school enrollments led to a reduction in property tax burdens to 3.27% of personal income in 1982. Many observers at the time saw the trend of lower reliance on property taxes as likely to continue. Legislators and governors, with few exceptions, committed themselves to relieve property tax burdens by a wide variety of measures.

The expected further decline in property tax reliance didn't happen. By 1990 (latest Census data) property taxes as a percentage of personal income had risen from the low of 3.27% in 1982 to 3.57%. The percentage will probably be even higher in 1991 and 1992. Property taxes have continued to rise with both rate increases and the delayed impact of increases in property values of the late 1980s. While property taxes rose, personal income growth was slowed by recession, tending to increase the percentage of personal income taken by property taxes.

The latest National Income Accounts data, shown on the chart, show property tax revenues in 1991 rising faster than either sales tax revenues or total state and local receipts. As the economy recovers, sales tax revenues should rise more rapidly than in 1991. Cost shifts to local governments associated with tight state budgets may also push property taxes higher.

Something, perhaps the contradiction between a commitment to reduce property tax reliance and actions that increase that reliance, caused several panels on property taxes to play to overflow audiences at the National Conference of State Legislatures (NCSL) meeting in late July. In one, Steven Gold (Center for the Study of the States) described the property tax trends, speculated on the factors causing them, analyzed how to control them, and concluded, "I have recently become convinced that states are going to shift more responsibility for raising taxes to local governments." He cited as examples **California**, **Maryland**, **Minnesota**, and **New York**.



Massive Differences Among States

The salience of property tax issues varies greatly among the states. By the representative tax system (States In Profile, Table D-21), sixteen states have property taxes that are 25% or more above the national average. Among the more populous states, these are #2 **Michigan** (57% above average), #3 **Iowa** (52%), #4 **Oregon** (52%), #5 **New York** (51%), #6 **Wisconsin** (47%), and #9 **New Jersey** (36%). Measuring property taxes as a percentage of personal income (Profile, Table D-9) propels some sparsely populated states (**Alaska**, **Wyoming**, **New Hampshire**, **Montana**, and **Vermont**) to the top in property tax burdens. By this measure, the larger states with the highest burdens are #5 **Oregon** (5.4% of income), #7 **New York** (4.8%), #8 **New Jersey** (4.8%), #10 **Michigan**, and #11 **Wisconsin** (4.6%).

By either measure, the lowest property taxes are found in the Southern states and Hawaii. About fifteen states have property tax burdens that are less than 80% of the national average, assessed by either measure of burdens.

The burdens of property taxes on particular types of property, such as residential and manufacturing, vary even more. Some states have constitutional uniformity provisions requiring that all property be taxed at uniform rates. Other states have classification systems that subject some classes of property (often commercial, industrial, and utility) to higher taxes than other classes (often residential and farm). Comparisons of burdens on particular types of property aren't available except for agricultural property. The table on the next page shows statewide average farm taxes. Only 27 states fall within the range of annual property taxes between 0.5% and 1% of the market value of farms. Farm taxes are particularly high in **Michigan**, **Wisconsin**, **Arizona**, and **New York**. Some Southern states have taxes that are less than a third of one percent of value.

Property Taxes On Farm Real Estate, Percent Of Market Value, 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Michigan	3.30%	17	Massachusetts	0.71%	34	Wyoming	
2	Wisconsin	2.14	18	North Dakota	0.67	35	Tennessee	0.42
3	Arizona	2.10	19	Colorado	0.66	36	Utah	0.42
4	New York	1.96	20	Indiana	0.65	37	Maryland	0.41
5	Nebraska	1.35	21	Washington	0.64	38	Arkansas	0.40
6	Vermont	1.21	22	California	0.63	39	Missouri	0.37
7	Illinois	1.10	23	Montana	0.62	40	Oklahoma	0.37
8	Oregon	1.04	24	Connecticut	0.59	41	South Carolina	0.37
9	Iowa	0.99	25	Hawaii	0.59	42	Mississippi	0.29
10	Rhode Island	0.96	26	Florida	0.57	43	Kentucky	0.28
11	New Hampshire	0.94	27	Georgia	0.55	44	Louisiana	0.28
12	Pennsylvania	0.94	28	Kansas	0.55	45	Nevada	0.27
13	South Dakota	0.87	29	Maine	0.55	46	New Mexico	0.21
14	New Jersey	0.86	30	Texas	0.52	47	West Virginia	0.19
15	Minnesota	0.81	31	Idaho	0.51	48	Alabama	0.16
16	Ohio	0.78	32	North Carolina	0.48	49	Delaware	0.08
	United States	**0.78**	33	Virginia	0.47	50	Alaska	n.a.

These relative tax levels tend to be stable over time. Nationally, the percentage of value taken by property taxes on farms rose from 0.76% to 0.78% between 1989 and 1990. Taxes were higher in 34 states and lower in 13 states. Farm taxes are at about the level of the 1970s. They are up somewhat from the mid-1980s, but down somewhat from the 1960s.

Differing Approaches To Property Tax Reform

Sharp regional differences in reliance on property taxes and in property tax burdens have shaped attitudes about what constitutes property tax reform in individual states.

In high property tax states, reform means relieving pressures on the property taxpayer. The most comprehensive method has been the indirect attack that results from using state revenues to increase the percentage of school costs paid by states, reducing the percentage paid from local property taxes. Heavy use of local option sales and income taxes to finance cities and/or counties has also helped. Long-standing examples are **Ohio**, **Pennsylvania**, and **Tennessee**. More recently, county option sales taxes have been authorized in **South Carolina** and **Wisconsin.** Their use is spreading as counties in these states persuade voters to exercise the local option. To deal with remaining property tax burdens, the states with high property tax burdens have also invested heavily in the types of relief programs described in the next section.

In low property tax states, reform means *increasing* reliance on the property tax. Examples of recent changes or serious proposals for change include: (1) possible higher taxes on agricultural and timberlands (e.g., **Alabama** and **West Virginia**), (2) termination or restriction of large homestead exemptions (**Florida** and **Louisiana**), and (3) raising the local property tax effort in state school finance (**Georgia**, **New Mexico**, and **Texas**).

State Property Tax Relief Programs

Many states have adopted measures to reduce the burden of property taxes, such as homestead exemption and credits, circuit breakers, and deferral programs. A 21-page summary of these measures in each state was recently published by NCSL as State Property Tax Relief Programs For Homeowners And Renters.

State Property Tax Relief Under Attack

At the NCSL meeting N.J. Assemblyman Kamin (R) told legislators that "attitude adjustment time" had arrived, a time when legislators would need to recognize that state governments cannot afford large state-funded property tax relief programs. He reminded them of the giant **New Jersey** tax increase of 1990. It funded direct property tax relief in the form of checks of up to $500 per household. It funded indirect relief through large hikes in school aid for less affluent districts and special aid for fiscally pressed areas like Camden and Newark. The package proved extremely unpopular with voters, leading to a change from Democratic majorities to veto-proof Republican majorities in the elections of 1991. The new legislature, despite a worsening state fiscal posture resulting from recession, rolled back the sales tax by one cent. The largest single cut in spending was a sharp cutback of the property tax relief program.

Indirect support for the attack on the state property tax relief programs came from James Scherzinger (Oregon legislative fiscal staff) who reported that **Oregon**'s property tax relief and administrative reforms didn't deter voter approval of Measure 5, a property tax rollback approved by initiative.

The continuing discussions of trying to balance the **California** state budget show that programs supporting local government in the name of property tax relief are in trouble. In mid-July, Democratic legislative leaders met with city officials. House Speaker Brown told them that the state can no longer continue the subsidies begun in 1978 when Proposition 13 dramatically reduced property taxes. He told the unhappy local officials: "We need a response from you that's constructive. You have got to be helpful. Otherwise, the process is going to move in spite of your reticence." There is now serious discussion among majority legislators (D) of allowing higher local option sales taxes.

In **Massachusetts**, local governments continue to object to the state strategy for budget balancing. As Boston Mayor Flynn put it in late July, "Clearly, it is no exaggeration to say that state government fiscal stability is being purchased at the expense of local government services." He objected to cuts in local aid and to the governor's recent veto of legislation that would have eased the Proposition 2½ property tax limits. He argued that the state was cutting its taxes by putting fiscal pressure on local governments.

Unfunded State Property Tax Limits

The Oregon initiative provides for the state to offset losses in school funding resulting from the tax limits, but not all relief measures include this offset. In the same panel, Michigan Treasurer Douglas Roberts explained the governor's proposal for relief which was put on the November ballot by initiative. The "cut and cap" measure closely resembles California's Proposition 13 by capping increases in assessments on individual properties to the lesser of inflation or 3%. It also provides for a five-year phase-in of a 30% cut in school operating taxes. The state would reimburse the districts for the cut, but not for losses from the cap. There is no provision for increasing state revenues to cover the added state cost. Roberts estimated the FY 1994 state cost at $448 million, which would require nearly a 5% growth in revenues from existing taxes for this item alone.

A competing proposal by Michigan Democrats also limits property taxes, but fully funds the local government's loss with business tax increases. It failed to meet the signature requirement to go on the ballot. Over the last decade, Michigan leaders of both parties have favored plans to increase the sales tax and relieve property taxes for school finance. Proposals to do this need voter approval because the state constitution limits the sales tax to the current rate. The proposals haven't fared well with voters, getting 28% support in 1981, 28% in 1989 for a version with a half-cent sales tax increase and no guaranteed property tax cut and 24% for a two-cent increase with guaranteed property tax reduction.

Policy Prescriptions

At the conclusion of his presentation, Steven Gold suggested four state policies, all recommendations of NCSL's State-Local Task Force, to deal with local fiscal problems to help alleviate pressures on property tax revenues:

- Don't just reduce aid; target reductions based on needs and local fiscal capacities.
- Reconsider mandates and relax or repeal those that are no longer appropriate.

- In providing more revenue options for local governments, take steps to guard against fiscal disparities, such as by requiring that revenue be shared between places with large and small tax bases.
- Use state-financed tax credits to cushion the burden of regressive local taxes on low-and moderate-income households.

The other panelist (Hal Hovey, **Reports** editor) suggested that if substantial property taxes were to be permanent parts of state-local revenue structures, there were some politically viable steps legislators could take to minimize problems. His list:

- Clean up property tax administration by such measures as current value assessments.
- Adopt property tax deferrals (not exemptions) for the elderly and poor.
- Preserve the property tax base against proposed new exemptions.
- Spread large utility, commercial, and industrial property tax bases among local jurisdictions to avoid inequities, as **Michigan**, **Minnesota**, and **Mississippi** are doing.
- In making tax policy, consider state and local taxes together, as recommended in NCSL's Principles Of A High-Quality Revenue System.

Harry Green (Tennessee ACIR), who moderated the panel, emphasized concerns over erosion of the property tax base including: (1) preferential treatment of agricultural and open space land, (2) homestead exemptions, (3) exemptions for not-for-profit and governmental organizations, (4) economic development exemptions, (5) various exemptions and evasions affecting personal property such as computer software, and (6) federal preemption under the Railroad Revitalization And Regulatory Reform (4-R) legislation.

WHAT HAPPENS WHEN FEDERAL POLICY CHANGES?

The past five years have seen more stability in federal policy than has been seen since at least the 1960s. There have been no major changes in federal tax law since the 1986 tax reform legislation. Grant spending classified as entitlements, particularly AFDC and Medicaid, have had stable policy and funding. This has expanded with higher state spending as well as the impact of some cost-increasing mandates. Other grant spending has been subject to incremental revision, but massive new programs haven't been established and old ones haven't been abolished. For at least the past three years, the predictions of federal policy underlying state budgets have been right on the mark.

This situation could rapidly end. Any serious attempt to *reduce* the federal deficit would have an impact. A serious attempt to *eliminate* the deficit could have massive impacts, as suggested by the plan prepared for the Perot campaign for President. Proposals for restructuring of state and federal roles, typified by a new book by Alice Rivlin, are indicative of how federal-state fiscal roles might evolve.

Balancing The Federal Budget

Governor Clinton's and the President's proposals to reduce the deficit seem to bracket the likely changes. The changes are likely to be incremental, with little drastic effect on state budgets. Changes in federal taxes, such as the President's interest in lower capital gains rates and Clinton's interest in higher top bracket rates, would probably lead to some conforming changes at the state level, but states would have options in dealing with them. In spending, the impact outside of health care would likely be less generous funding of domestic discretionary programs, including reductions in grant programs.

National health insurance is the big unknown. Some of the plans would replace or substantially alter Medicaid. However, the plans are so expensive that they are unlikely to be vehicles for immediate state fiscal relief. Instead, they are designed to require continuation of some state funding for indigent care. The fiscal relief would appear as avoiding future state health care cost increases.

The Perot Prescription

The more interesting, but apparently remote, concern is what would happen if there were a determined effort to eliminate the federal deficit quickly. Such a scenario might be triggered by such a development as a collapse of international confidence in the dollar or accelerated inflation coupled with such high long-term interest rates that the housing industry and business investment appeared threatened. The leaked economic plan provided for the Perot campaign provides a basis for examining what might happen in such an event.

Most of the actions to control costs and/or increase revenues associated with Social Security and Medicare would have little impact on states except to the extent that states would be affected, like other employers, by increased employer taxes. The family of alternatives includes: (1) cutting the value of Social Security retirement benefits by such moves as: (a) phasing in a further increase in the retirement age, and/or (b) increasing the portion of benefits subject to tax in higher income households, such as the increase from 50% to 85% in the Perot plan, (2) cutting the net cost of Medicare by: (a) higher payroll taxes for Part A (hospital) coverage, including expanding the base of the current tax to the portion of income exceeding $130,000, (b) higher copayments for Part B (doctors and other) coverage, and/or (c) more extensive controls on utilization or provider reimbursement rates.

Many of the attacks on federal spending are likely to be outside the area of federal grants — including the defense budget, space exploration, and agricultural subsidies. The plans are likely to freeze most domestic discretionary spending, including grants, and perhaps impose percentage cuts like the 10% in the Perot plan. Individual grant programs, such as mass transit, may also be on hit lists. The candidates have also discussed higher spending on selected grant programs. Bush likes Head Start, preventive health, urban aid, and education. Clinton likes infrastructure, the environment, drug treatment, and Head Start.

The Perot and Clinton plans include higher personal income tax rates on high bracket taxpayers, a change with no direct impact on states. Perot's includes a tax on employer contributions to employee health care above a minimum level, a feature also found in many of the health finance proposals. This would increase the tax base for conforming states as well, as would other Perot proposals such as altered rules for transfer pricing and deductibility of entertainment expenses in the corporate tax law. Federal excise taxes — gasoline, tobacco, and/or alcoholic beverages — would also be on the increase list, though Clinton and Bush haven't been emphasizing them. A 50 cent hike was in the Perot plan. While having no technical effect on state taxes on the same commodities, sharp federal tax increases would depress demand and thus state tax revenues.

The Rivlin Recommendation

> *There were good historical reasons why power flowed toward Washington from the 1930s to the beginning of the 1980s. Similarly, there are now equally cogent reasons for reexamining the federal structure and dividing responsibilities more clearly between the states and the national government: revitalizing the economy and making government work better.*

With these words Alice Rivlin, first director of the Congressional Budget Office, concludes her new book Reviving the American Dream (Brookings, 1992). Rivlin attacks the "enormously confusing overlap of responsibilities" between state and federal governments. She argues that now is the right time to rethink the fundamental questions of federalism — which level of government should do what and how they pay for doing it.

Rivlin urges a more precise division of federal and state responsibilities. The federal government would concentrate on areas in which it is uniquely qualified, such as national defense and international relations, and leave most domestic policy to the states. They would accept a "productivity agenda", including education, job training, housing, transportation, and economic development. The federal government would "devolve" in these areas, dropping both funding and mandates. With the savings, the federal government would take responsibility for health care reform, including universal coverage. These offsetting federal costs and savings would still leave the budget unbalanced. Rivlin sees higher federal taxes as the only solution.

To cover their increased responsibilities, Rivlin believes the states would have to restructure their revenue systems. States would have to stop competing with each other on the basis of fiscal strength. She proposes "common shared taxes" as part of the solution -- a national sales tax or a value-added type of corporate tax which could be distributed among the states on some equitable basis such as population. States would also be encouraged to harmonize their tax treatment of corporate income to reduce administrative costs and to reduce inter-state competition. If health care is nationally available, then she says other social services could be administered state by state without large deviations in equity, particularly if all states had roughly equal per capita revenues through shared taxes.

The proposed restructuring resembles the "sorting out" proposals which intrigued many governors and the Reagan Administration in the early 1980s. The grand sorting out envisioned by the negotiations never took place, but federal grant funding has evolved to more emphasis on income-tested programs like AFDC and Medicaid relative to other grants. The idea of states harmonizing tax bases was reflected in the initial federal revenue sharing legislation. It offered states the option of piggybacking on the federal income tax, complete with use of the IRS to collect state taxes. No state, however, took advantage of the federal offer.

Rivlin's book is not a legislative agenda. There is no specific advice on how to implement the proposed changes, many of which would require federal action as well as coordinated actions by all 50 states. Reviving the American Dream is a useful framework for discussion. Although it will probably be read more in classrooms than in offices, its ideas are close enough to reality that Rivlin was scheduled as a key speaker at this summer's meeting of the National Association of State Budget Officers. National Governors' Association executive director Ray Scheppach reflected some of the same thinking in telling the press, as the NGA August meeting convened, that governors were increasingly taking over domestic programs. He commented that the federal government "is just too big to do it." He suggested that the federal government can provide some minimum standards and some financing, but "there is no way that they are going to be able to run these programs out of Washington."

HEALTH CARE UPDATE

Provider Taxes: At its annual meeting, NCSL gave the media an assessment of the impacts of the federal Medicaid Moratorium Amendments, based on the group's survey of states. There are 12 states that had donation programs disallowed under the legislation. Thirty states had some type of provider assessment "in place or pending prior to federal law changes." Of these, 28 will require significant changes. NCSL concludes, "The restrictions the federal government has placed on provider taxes will cause significant disruptions in state Medicaid programs and will guarantee Medicaid will remain one of the most pressing state budget issues for the next two to three years."

For many states, the first major compliance date under the new law is September 1. The federal implementing regulations haven't been published, so "states will essentially be on their own" in determining what constitutes compliance.

Many states have left themselves work to do on controversial Medicaid financing measures. For example, in signing the new provider tax measure in July, **Illinois** Governor Edgar commented, "We're not out of the woods on the issue of health care in this state." The measure raises over $700 million annually from providers and an equal amount in federal matching funds to help cover Medicaid costs running at about $4 billion. The new tax is 2.5% of hospital net revenues, $6.30 per bed-day in nursing homes, and 13% of gross receipts for facilities for the developmentally disabled. Opposition by some hospitals led to making the tax temporary, so renewal or replacement will be an issue next year. As in other states, health providers would prefer that general taxpayers pay the cost.

The Illinois plan has a feature to offset its increase in nursing home costs for families paying their own nursing home bills. The plan risks federal disallowance as an attempt to make a legal provider tax program affecting all patients into an illegal donations program, with effects concentrated on Medicaid-funded nursing home services. Other states — such as **Louisiana**, **Tennessee** and **West Virginia** — have features in their provider taxes that may lead to disallowance, depending on how the federal legislation is interpreted.

Public Hospitals: The trend to sever ties between state and local governments and public hospitals continued with the recent announcement of more autonomy for the New York City Health and Hospitals Corporation, the nation's largest public hospital system. Like the 11 hospitals that Louisiana recently shifted, the New York hospitals will be more fiscally autonomous, keeping their own profits and eating their own losses as encouragement for more businesslike operations. The New York system is highly dependent on public programs, getting 72% of revenues from Medicaid, nearly 12% from Medicare, and 7.4% from the city for both purchased services for city employees and subsidies for non-paying patients.

State-Subsidized Indigent Care Plans: Continuing fiscal problems in states that have been most aggressive in trying to expand health care availability to the uninsured are setting limits on those programs. **Hawaii**'s governor recently vetoed an extension to certain short-term workers. **Maine**'s limited program is likely to be a casualty in the governor's new budget. The second phase of Health Care for Montanans is in trouble, for reasons expressed by its coordinator:

> *I don't know how much health care reform we can do when there isn't even spending change for seed money to try anything. The programs will be hurt because there's no money to even get started on things with long-range benefits. The budget problem stifles people's imaginations.*

Oregon Plan Rejected: Oregon has adopted a plan to alter health care for the poor by: (1) expanding eligibility substantially while (2) controlling costs. This includes eliminating some current low-priority mandated Medicaid coverage, including institutional care where home health care would work, and some expensive treatments (e.g. transplants, late states of AIDS). Before implementation, the plan had to achieve a federal waiver of federal Medicaid requirements. That waiver was rejected by federal officials in early August, but the state was invited to go back to the drawing board to produce a new plan. Critics suggested the Administration was seeking to get the issue off its desk before elections without turning it down completely.

FISCAL CONDITIONS POOR

FY 1993 Budget Outlook

Introduction: The first summary of this year's state budget actions appeared in late July when NCSL released its preliminary version of State Budget And Tax Actions: 1992. The report is based on actions of 40 states, excluding some late-acting large states including **California**, **Illinois**, and **Michigan**. Their inclusion in the final version, promised for September, won't improve the national picture. The report's summary calls the state outlook "as clouded as that of the national economy." It concludes:

> *State finances are at a very low point. Slow employment growth in most states indicates that economic recovery will continue to be slow. States have tended to respond with budget cuts and have limited tax increases to a much lower level than in 1990 and 1991. As revenue forecasts show, state officials do not expect significant recovery in FY 1993....*
>
> *Like last year, the states have enacted austere budgets that could easily come unglued if the economy falters further, or if federal mandates or other external forces drive health and welfare spending beyond budgeted levels.*

Fiscal Strategy And Balances: FY 1992, which ended for most states in June, turned out to be one of the worst years in state financial history. Unexpected revenue shortfalls and higher-than-expected expenditures led to mid-year budget adjustments that, nationwide, proved inadequate to maintain balanced budgets. As a result, instead of increasing their balances to the 5% of spending that many states use as a target, balances eroded from 2.6% of spending at the beginning of the fiscal year to 1.4% at the end. Reported revenue growth was only 4.2% despite substantial tax increases enacted in 1991.

The national pattern in fiscal strategy was to avoid major tax increases and sharp spending cuts. As a result, only a slight recovery in balances, to 1.7% at the end of FY 1993, is reflected in the enacted budgets. The balances are highly concentrated in a few states with five states — **Alaska**, **Kansas**, **Indiana**, **Minnesota**, and **Oklahoma** — holding over half of the end-FY 1993 total.

Revenues — Slow Growth With Few Tax Increases

General fund revenue growth in FY 1992 was 4.2%. A revenue increase of 7.1% is expected for FY 1993, about 5.7% associated with normal economic growth and about 1.4% associated with tax increases. The tax increases are down substantially from the 5.4% reported for FY 1992. Two states reported major tax cuts. **New Jersey** rolled back a previous one-cent increase in the sales tax. **Pennsylvania** rolled back, as scheduled, some of the tax increases adopted in 1991. The largest tax increases were in **Iowa**, **Kansas**, and **Maryland**. Health care provider taxes accounted for 42% of the tax increases reported in the survey.

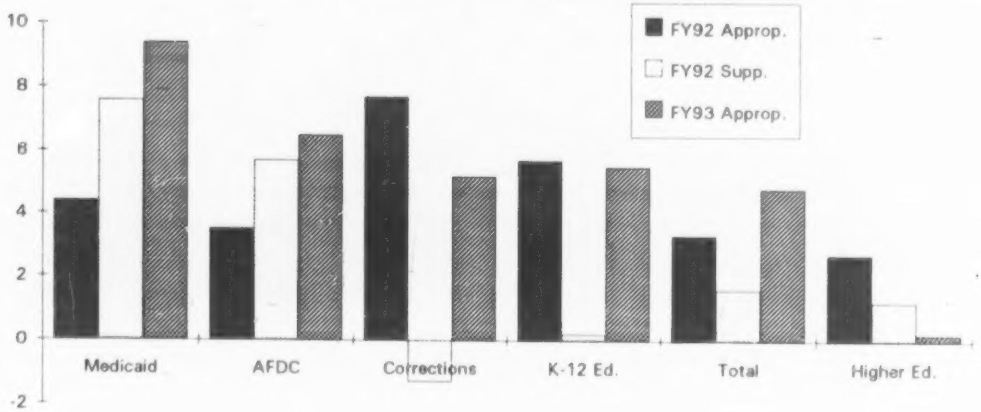
Spending Priorities And Risks Unchanged

The overall spending increase reflected in the enacted budgets was 4.8%, about the same as the actual increase in FY 1992. The FY 1993 number will probably grow with the enactment of supplemental appropriations later in the fiscal year.

The NCSL survey shows that FY 1993 budget increases are reflecting a familiar pattern, which is shown graphically on p. 14. The budgeted increases for the new fiscal year (shown in the third column for each program) are 4.8% for total general funds. Public school increases (5.5%) are above total budget increases (4.8%), as are the increases for Medicaid (9.4%), AFDC (6.5%), and corrections (5.2%). Higher education (0.2% increase) and all other programs (not shown) fared the worst.

Will actual spending increases correspond to what was approved in the FY 1993 budgets? Unlikely, if the experience of FY 1992 is repeated. During the year the original increase (first columns of the graph) were increased by supplemental appropriations to cover spending overruns (middle columns). These adjustments are minor in elementary and secondary education. They were negative for corrections, where appropriations for capital outlays often aren't entirely spent in one year. They were massive for AFDC and Medicaid. *In both these programs, more of the increased FY 1992 spending was appropriated in supplemental budgets than in regular budgets.* Put another way, by error or design (often both), state officials adopted budgets apparently giving larger increases to K-12 education than Medicaid and AFDC, then implemented budgets that did the reverse. This pattern could be repeated in FY 1993, driving up the costs of these programs and total state spending.

Percentage Growth By Spending Category
FY 1992 Budget and Supplementals, FY 1993 Budget



The Fiscal Outlook

Many of the enacted state budgets, **Reports** continues to believe, will be changed substantially before the fiscal year is over. Absent a striking improvement in national economic circumstances, some legislatures and many governors are likely to be making post-election budget adjustments to deal with: (1) higher-than-expected spending, particularly in Medicaid and AFDC, (2) Medicaid financing including provider taxes, and (3) major tax issues not concluded so far this year including school finance in **Texas**, dealing with Measure 5 in **Oregon**, and possible revival of major tax reform in **Alabama**, **Louisiana**, and **Tennessee**, and (4) patching fiscal solutions such as the one adopted in **Illinois**, and the one likely to be adopted in **California**.

Many of the state situations that are likely to require patching before the fiscal year is out aren't being discussed in the pre-election environment. One exception was Governor Edgar's comments on the **Illinois** budget, which he publicly characterized with phrases such as "out of whack," "fake cuts," and "smoke and mirrors." These concerns weren't seriously addressed by his vetoes, which affected only about 0.1% of the total. Why approve a bad budget? Edgar's answer was:

> *I feel I have no choice but to sign this budget because we are in the midst of an election year and we probably can't expect anything better than what we have.*

At the NCSL meeting, the organization's president-elect (Art Hamilton, minority (D) leader of the Arizona House) called the fiscal situation "ugly," but suggested that states could grow out of recession.

The NCSL survey suggests that state officials are generally assuming a steadily growing economy (about 3% real growth) in FY 1993. Slower recovery would exacerbate an already poor situation. Significantly faster growth or rapid inflation would bail out many states. Hamilton warned about the fiscal effects of additional federal mandates, suggesting "The battle cry of this conference should be 'No more mandates'."

In addition to the unknown factor of possible additional mandates, such as those that might be involved in federal action on health care, there are a significant number of previously enacted mandates which are gradually increasing their fiscal impact on state and local budgets. At the state level, the most significant ones are in Medicaid and social services. At the local level, the growing bites of federal drinking water and pollution control measures are increasingly becoming apparent.

A recent Stateside Associates poll of legislative leaders asked for the dominant issues in the legislative sessions this year. Budget/tax issues were mentioned by 88% of respondents, massively more than the next highest issues, health care (33%) and education (30%). Next year, the respondents expect budget and tax issues to have somewhat less importance (73%) and education to rise in importance (53%). Absent more good news on the nation's economy than has appeared so far, legislators may face another year of legislative sessions in which fiscal pressures tend to drive other issues far down on their agendas.

Local Governments Under Pressure

Although no reliable quantitative information is available, fiscal pressures on local governments in most states have clearly been increasing. A recent survey of cities shows declining balances and enactment of tax or fee increases by 72% of the responding city officials. Property tax rates were raised by 29% of the cities. Over half raised fees and charges while 29% adopted new fees.

The causes are well understood: (1) recession impacts on revenues and spending, (2) the translation of stagnation in real property values into assessed values, (3) cutbacks in state aid in some states, and (4) the continuing impact of shifts in federal spending toward state-oriented programs like AFDC and Medicaid and away from locally oriented programs like Community Development Block Grants and economic and community development programs generally.

HOW SIGNIFICANT ARE STATES?

Ranking States And Countries

California officials are fond of the line, "If California were a country, it would be ranked seventh among the economies in the world." For those who like such comparisons, the National Governors' Association recently issued a sheet that provides rankings using: (1) gross national product for countries, (2) gross state product for states, and (3) gross sales for corporations.

The less interesting comparison is between states and companies. Using gross state product for states means that 13 states are economically more significant than the top-ranked corporation (General Motors with sales of $126 billion). Over half the states outrank #5 company IBM. Every state ranks in the top 50 of the Fortune 500. State claims for size relative to corporations would be much more modest if revenues of state government, or state and local governments combined, were compared with company gross sales.

Comparing aggregate economic activity of states and nations provides interesting results for all states. Some examples from the NGA fact sheet are shown below. The table shows the state, the state's rank if it but no other state were ranked as a nation, the state's rank if all states were ranked as countries, the smallest country with a larger economy than the listed state, and the largest country with a smaller economy than the state.

Comparing Gross Products Of States And Countries, 1989

State	Rank*	Rank**	Just Below	Just Above
California	7	7	United Kingdom	Canada
New York	8	9	Canada	China
Texas	11	13	Spain	India
Illinois	12	15	India	Australia
Pennsylvania	14	18	Netherlands	Switzerland
Florida	14	19	Netherlands	Switzerland
Ohio	14	20	Netherlands	Switzerland
New Jersey	14	21	Netherlands	Switzerland
Michigan	17	25	Sweden	Mexico
Massachusetts	19	28	Belgium	Austria
Wisconsin	22	39	Denmark	Norway
Louisiana	26	47	South Africa	Turkey
Colorado	29	52	Poland	Thailand
Oklahoma	34	62	Algeria	Venezuela
Arkansas	41	74	Columbia	Malaysia
New Mexico	49	89	Hungary	Peru

* If state were a country, it would be the __ largest country in the world.

** If all states were countries, this state would be the __ largest in the world.

The new wrinkle in these comparisons is appearing in **California**. State officials and private observers have been comparing the state's $11 billion budget gap with other country economies and other state budgets (e.g., the gap is larger than the entire national product of X countries and larger than the total budgets of Y states.).

Ranking States And Companies

State governments also are impressively large when their revenues are compared with the revenues of large companies. A new compilation combines data for state general revenues and company sales (both FY 1990) showing that 26 states would, if they were companies, be ranked in the top 100 of the Fortune 500 companies. The table below follows the format of the previous one to show selected state rankings.

Comparing Gross Products Of States And Companies, 1990

State	Rank	Rank	Just Below	Just Above
California	4	4	Ford Motor	IBM
New York	7	8	General Electric	Philip Morris
Texas	14	16	Boeing	Shell Oil
Pennsylvania	16	19	Procter & Gamble	Occidental Petroleum
Illinois	18	22	United Technologies	Dow Chemical
Florida	18	23	United Technologies	Dow Chemical
Ohio	19	25	Dow Chemical	USX (U.S. Steel)
Michigan	19	26	Dow Chemical	USX (U.S. Steel)
New Jersey	23	31	Xerox	PepsiCo
Massachusetts	25	34	McDonnell Douglas	ConAgra
North Carolina	37	47	Allied-Signal	Sun (Oil)
Maryland	47	64	Bristol-Myers	Coca-Cola
Arizona	70	94	Honeywell	Am. Home Products
Mississippi	112	143	Dresser Industries	Johnson Controls
Rhode Island	181	221	National Steel	Sun Microsystems
South Dakota (smallest)	294	343	Hartmarx (cards)	American Greetings

Ranking States And Local Governments

The same technique can be used to intersperse local governments with state governments using revenues as the basis for comparison as shown on the table (next page). Only the local governments shown have revenues greater than the lowest state. Most of the local governments shown have multiple functions. The exceptions are the cities of Los Angeles, Chicago, and Detroit, and Los Angeles County. Philadelphia, San Francisco, Miami-Dade, and New York have both city and county functions. The District of Columbia handles city, county, and state functions.

Comparing Revenues Of States And Local Governments, 1990

Local Government	Rank	Rank	Just Below	Just Above
New York City	9	9	Michigan	New Jersey
Los Angeles County	33	34	Mississippi	Alaska
Los Angeles City	39	41	New Mexico	Hawaii
District of Columbia (city-state)	39	42	New Mexico	Hawaii
Chicago	43	47	Rhode Island	New Hampshire
Philadelphia	43	48	Rhode Island	Hawaii
San Francisco	48	54	Delaware	North Dakota
Dade County (Miami)	49	56	North Dakota	South Dakota
Detroit	50	58	South Dakota	Vermont

MISCELLANY

Housing Advances Unevenly

Housing statistics often provide a good indicator of state economic turnarounds because major upturns or downturns tend to be magnified in the housing market. This year is no exception, as suggested by the table.

Percentage Increase In Residential Building Permits
January-April 1991 To January-April 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Montana	93%	18	Illinois	33%	34	Rhode Island	16%
2	Wyoming	77	18	Missouri	33	34	West Virginia	16
3	Colorado	66	18	North Dakota	33	36	New Hampshire	14
4	Kentucky	51	21	Oklahoma	32	38	South Dakota	14
4	Louisiana	51	22	Indiana	30	38	Oregon	13
6	Idaho	50	22	Texas	30	39	Arkansas	11
7	New Jersey	47	24	Wisconsin	29	39	Pennsylvania	11
8	Mississippi	44	25	Connecticut	27	39	South Carolina	11
8	Utah	44	25	Massachusetts	27	42	Maine	8
10	Arizona	40	25	Washington	27	43	Vermont	7
11	Nebraska	38	28	Minnesota	23	44	New York	5
12	Kansas	37	28	Ohio	23	45	Florida	3
12	Maryland	37	30	Virginia	22	46	Delaware	1
14	North Carolina	36	31	Georgia	21	47	Alaska	-9
15	Alabama	34	31	New Mexico	21	48	California	-13
15	Iowa	34	33	Michigan	20	49	Nevada	-14
15	Tennessee	34		United States	**18**	50	Hawaii	-42

Nationally, starts were up by 18% in the first third of 1992 compared with a comparable period last year. Thirty states were within the range of a 36% to 0% increase. Three formerly rapid-growth states — **California**, **Hawaii**, and **Nevada** — showed dramatic declines. This has been reflected in their finances. California still doesn't have a budget because elected officials can't seem to solve a shortfall of $11 billion. Hawaii has a budget, after revising revenue estimates for FY 1992 downward to single digits and deciding that FY 1993 will see little growth. Nevada is making similar adjustments. The good news is the acceleration of already rapid growth in **Idaho** and **Utah** and revival in previously depressed mining-oriented economies of some states in the Far West.

Interstate Moves

The patterns of interstate moves recorded by a major van line provide a current indicator of the relative economic attractiveness of the states. The table ranks the states by the percentage of moves made by Allied Van Lines that were into each state.

Percentages of Allied Van Line Moves That Were Inbound, 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Oregon	66.9%	18	Florida	54.7%	34	Maryland	47.8%
2	Montana	66.0	19	Tennessee	54.6	35	Ohio	47.4
3	Nevada	63.5	20	Kentucky	54.3	36	Louisiana	46.9
4	Alaska	63.3	21	Mississippi	54.3	37	Delaware	45.1
5	Washington	62.7	22	Texas	53.1	38	Pennsylvania	44.9
6	Colorado	61.9	23	Kansas	52.9	39	South Dakota	44.9
7	Maine	61.9	24	Idaho	52.4	40	Wyoming	44.8
8	Georgia	60.9	25	West Virginia	52.3	41	Oklahoma	44.0
9	North Carolina	60.0	26	Minnesota	52.0	42	Illinois	43.4
10	Arizona	58.8	27	Wisconsin	50.6	43	California	42.5
11	Alabama	58.7	28	Indiana	50.3	44	Michigan	42.0
12	Vermont	58.2		**United States**	**50.1**	45	New Hampshire	41.3
13	South Carolina	57.4	29	Missouri	49.9	46	Massachusetts	40.5
14	New Mexico	57.0	30	Nebraska	49.8	47	New Jersey	39.5
15	Arkansas	55.7	31	Iowa	49.2	48	Connecticut	39.2
16	Hawaii	55.5	32	Rhode Island	48.8	49	New York	39.0
17	Utah	55.2	33	Virginia	48.1	50	North Dakota	35.4

The table shows familiar patterns: net migration into traditional retirement havens and rapidly growing states and outmigration from the Northeast and Midwest. But two New England states, **Maine** and **Vermont**, are among the leaders. The losers include Oil Patch states — **Louisiana Oklahoma**, and **Wyoming** — as well as states like **Massachusetts**, **New York**, and **Pennsylvania**. **California**, a traditional destination state, ranks 43rd.

Initiative And Referendum

Direct democracy procedures — initiative, referendum, and recall — are common in Western states (plus Massachusetts), but rare east of the Mississippi River. There has been little change in the past two decades. **New Jersey** was about the best prospect for adoption with its new veto-proof Republican majority in the legislature. Initiative is included in the party's platform and has been advocated by Republican legislators for a decade. It is also supported by Governor Florio (D) and by Hands Across New Jersey, the group that organized the state's tax revolt. But when the time came to put the constitutional amendment on the ballot by a late July vote, many Republicans defected to join the Democrats in opposition, so Garden State voters will not vote to decide what they can vote on.

Legislative Turnover

The record turnover of legislators this year was a major on-the-record topic and an even more significant hallway topic at the National Conference of State Legislatures meeting in July. NCSL staff expects the highest turnover since the 1960s, when the Supreme Court's "one-man, one-vote" decision caused massive shifts of representation from rural to urban areas. Contrasted with a usual turnover of about 20%, NCSL estimates that about 2,500 of 7,500 state legislators will be leaving office before considering whatever additional turnover is caused by voter decisions in the November elections. About 80% of all legislators are running this year. A survey of legislative leaders by Stateside Associates suggested 33% turnover nationwide.

The causes of the higher turnover aren't easily quantified. Reapportionment clearly accounts for some early retirement. Discussion of other causes concentrated on: (1) longer sessions and greater workload, (2) tougher formal and informal standards on conflicts of interest, inhibiting legislators from earning income beyond their legislative pay, (3) reaction to voter distrust of incumbents, and (4) inability to achieve constructive solutions because of fiscal constraints. No major changes in patterns of party control seem likely to result from the turnover, which seems to be affecting both parties in about the same way.

One result of turnover will be inexperience in influential positions. NCSL President Paul Burke (Kansas Senate President) said that the key committees in his state were likely to have freshmen as chairmen because nine major committee chairman weren't seeking reelection.

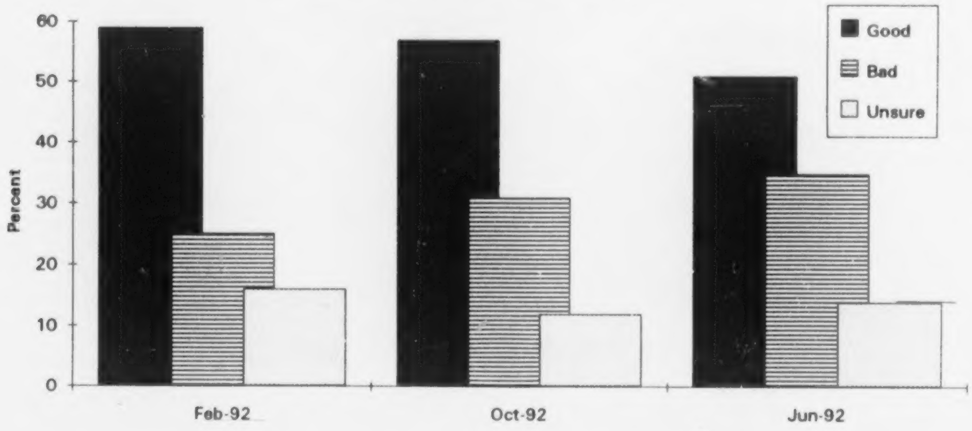
Public Approval of Gambling

A recent **Iowa** Poll by the Des Moines Register (7/12) suggests that enthusiasm for legalized gambling has waned slightly as the state experiences some setbacks.

Iowa's greyhound tracks are in financial difficulty. The only horse track closed three years after it opened. The first state to authorize riverboat gambling has competition from Illinois on the Mississippi River and possible competition from neighboring states considering riverboats on other rivers. Several Iowa-based boats have now shifted down river to Mississippi, which now permits them as well. Gambling operators are looking for ways to improve their finances, including reducing the restrictions and taxes on their operations.

The chart shows that a decreasing number of Hawkeyes, though still a majority, believe that legalized gambling has been good for the state.

Iowa Voters Answer
"Has legalized gambling been good or bad for Iowa?



Asked about specific forms of gambling, Iowa voters say they want all the current forms to remain legal. Support for continued legal status is highest for bingo (89%), followed by the lottery (81%), riverboat casinos (67%), horse racing (66%), and dog racing (66%).

Gambling also has its critics among elected officials in states where it has been most successful. For example, in July, Governor Chiles and the **Florida** lottery director had a news conference to announce a new sales record of $2.2 billion in FY 1992. But Chiles called the lottery "a fraud on the public, the lottery employees, (and) the retailers," because proceeds weren't being used to buy extras in the schools, like computers and pre-school. Instead, he said, lottery dollars were replacing general fund money that otherwise would have been provided to schools, and thereby making possible increased spending for programs like Medicaid.

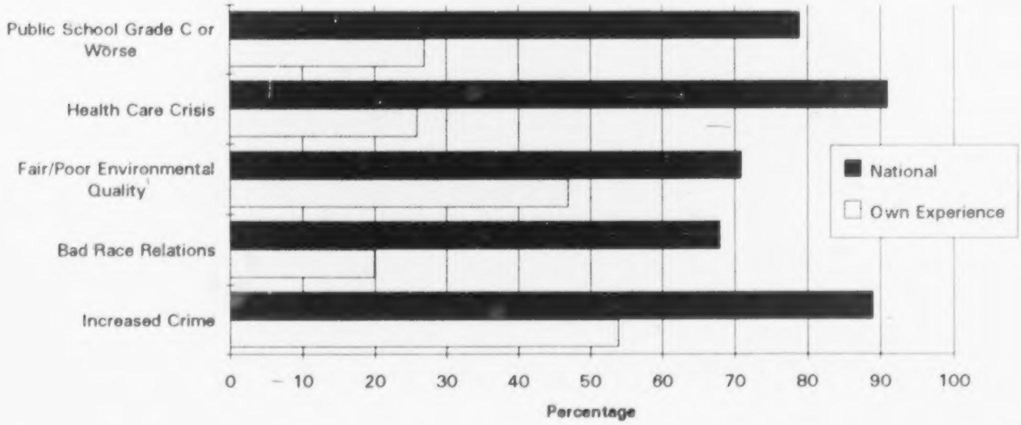
Chiles' remarks were rapidly picked up by opponents of the lottery measure on the November ballot in **Georgia**. Opponents are running adds portraying the lottery as a worm eating the educational apple. Governor Miller is spearheading the proponent's drive. He claims that Georgia has "learned from Florida's mistake" and that lottery money won't simply supplant other school funding.

Public Perceptions Of How Things Are Going

The public's perceptions of conditions in the United States do not appear to be based on personal observations. Polls consistently show Americans ranking Congress worse than their Congressman, legislators worse than their legislator, and economic conditions in the country worse than economic conditions in their household.

Polling data from differing sources reported in The American Enterprise (July/August) shows this perception difference applies to conditions like crime, the environment, and race relations as well.

Voters See National Conditions
Much Worse Than Their Own Community's



The practical significance of the consistent difference in perceptions of voters' own situations and national situations could be debated. The difference probably has something to do with the consistent success of incumbents in seeking reelection despite widespread dissatisfaction with national and state situations shown in opinion polls.

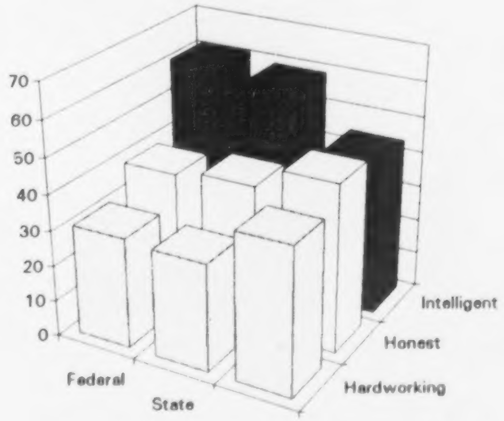
Vested Interests And State Voting

In his presentation at the NCSL meeting on property taxes, Michigan's treasurer included a calculation (which could be made for any state) which compares the number of persons with vested interest in state spending with the total number of people who voted in the last statewide election. It shows those with an interest constituting a majority of those voting assuming, which he concedes isn't true, that all those with a vested interest vote. Michigan has 715,000 state and local employees and retirees, almost 500,000 students at state higher educational institutions, and about 225,000 AFDC recipients.

Also Noted

More Junk Rankings: Value at zero or worse the state rankings (City & State, 7/13) that conclude that "New Jersey is the best of states and Nevada is the worst when it comes to protecting the environment." The magazine doesn't disclose how it made the rankings, doesn't even indicate how some states did, hasn't done well with its other rankings, and has results that don't seem to correspond to other measures.

Have Listed Characteristics, Illinois, 1991



Comparing Public Employees: Federal workers are more intelligent, but less likely to be honest or hardworking, than local and state workers according to 1991 survey (Illinois Issues, June). A sample of Illinois residents was asked if most, some, or just a few workers were hardworking, honest, and intelligent.

The results show states between federal and local. Responses on the level giving respondents the most for their money favored local governments (33%), over federal (29%) and state (28%).

Taxes By Any Other Name: Last year, **Texas** revised its net-worth-oriented franchise tax to include a calculation of liability based on income. This triggered continuing debate on whether the result is a corporate income tax or not. The distinction is important to Texans who like to say their state has no income taxes and who oppose a personal income tax. The state public utility commission entered the argument after permitting regulated utilities to pass along their extra taxes to consumers by specifying that the cost be separately stated on consumer bills as a "Corporate Income Tax Surcharge Approved by Texas Legislature." With a change in commission membership to a majority of Democrats, the entry will now read, "Cost of Service Surcharge."

Toll-Free In Virginia: This summer, tolls were eliminated on the **Virginia** section of Interstate 95 between Petersburg and Richmond and toll-taker jobs scrapped. The event runs counter to a trend to keep toll roads in operation to avoid adding their maintenance costs to state highway budgets, to make transfers to general funds by buying road segments (**New Jersey**), and arguably (in **Massachusetts**) simply to perpetuate self-finance authorities providing a bastion of power not easily controlled by state elected officials.

TECHNICAL NOTES

Property Taxes: The farm tax data come from the Department of Agriculture's Agricultural Resources: Agricultural Land Values And Markets (6/92).

Federal Impacts: The Perot plan was reported in U.S. News (8/3).

Fiscal Conditions: As usual, there are many caveats associated with national fiscal surveys. It is difficult to avoid shifting budget concepts from general funds to all funds particularly when gathering data on provider tax increases, which some states aren't treating as taxes, and in considering continuing current taxes, which NCSL counts as increasing taxes if a cut was scheduled (e.g., **New York**). The most recent report on city fiscal conditions was published in Nation's Cities Weekly (7/13). The annual report tends to show gloom and doom in good times and bad, but is particularly gloomy this year.

Legislative Turnover: Stateside Associates (2300 Clarendon Blvd., Arlington, VA 22201) is a state government relations consulting firm.

Comparing States And Companies: The comparison of states and companies, which **Reports** and the National Governors' Association have done from time to time, was done this year by The Governors Center At Duke University (Institute of Policy Sciences and Public Affairs, 4875 Duke Station, Durham, NC 27706) as The Fortune 500 And The 50 States. The local-state comparisons (from the obsolete 1987 Census of Governments), were done by the magazine City & State in its special publication City & State: 2000, published in early 1992. The NGA release is titled Comparison of States, Nations, and Corporations, 1989.

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VOLUME 10 ISSUE 16

IN THIS ISSUE

Corrections spending pressures are abating in some states, but not others. Different state choices on use of probation, parole, and early release programs explain many of the differences. The prevailing practice is to separate sentencing decisions from their cost consequences.

- Is The Corrections Crunch Ending? p. 2

As many states face tough fiscal choices in their FY 1994 budgets and some face shortfalls in the current year, there is new talk about structural imbalances. While experts debate whether this is a problem for states in the aggregate, it is clearly a problem in some states and not a problem in others.

- Built-In State Budget Deficits p. 9

There are conflicting signs of policy changes in seeking economic development, ranging from curtailing tax incentives in Alabama to continuing plant-by-plant, office-by-office competition for individual development projects. The latest job growth statistics show performance ranging from a 3% one-year gain in Idaho to a 3% loss in Connecticut.

- Economic Development Strategies p. 16
- Job Growth And Decline p. 18

Many states are adopting total quality management programs as part of reinventing state governments. Proponents are enthusiastic. Critics see another management fad.

- Total Quality Management p. 19

Miscellany covers late budget decisions and privatization. Technical notes detail sources and caveats.

- Miscellany p. 22
- Technical Notes p. 23

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August 1992 (Second Of Two August Issues)

IS THE CORRECTIONS CRUNCH ENDING?

Signs Of Change? In the late 1980s, corrections joined with Medicaid as the programs putting the most strain on state budgets. The trend continued in FY 1991 when, according to the National Conference of State Legislatures' fiscal survey, corrections spending jumped 17.6% over FY 1990 levels. Two recent indicators suggest double digit growth in corrections spending may be ending.

NCSL's preliminary fiscal survey, released in July, noted that corrections spending in FY 1992 presented the "surprise" of falling below original budget levels. An increase of 7.7% was budgeted, but actual increases were an estimated 6.4%. This performance was in marked contrast to Medicaid, where budgeted increases of 4.4% turned into actual spending of 12% above FY 1991. The corrections increase budgeted for FY 1993 in the 40 states in the NCSL survey was 5.2%, barely above the 4.8% increase for total general fund spending. A second indicator of possible change was a slowdown in the growth of prison populations in California.

It is hard to tell what the future will bring. In making its long-term general fund forecast last fall, California's Commission on State Finance assumed that the Department of Corrections (CDC) forecasts of 5.3% annual increases in inmates and 6.3% increases in parolees would prove accurate. This would be slower growth than experienced during the 1980s. The Commission's comments are indicative of national uncertainty on this topic:

> *There are conflicting trends which could cause actual caseloads to be either higher or lower than the CDC forecasts.... They could be higher if the current lull in prison admissions merely reflects temporary administrative factors — such as changes in police practices or budget constraints of local criminal justice agencies — rather than more fundamental changes in social conditions.*
>
> *On the other hand, inmate population growth could be less than the CDC estimates if the recent declines represent more fundamental demographic and societal changes. For example, the male cohort group age 20-44 which accounts for nearly 90% of the institution population, is projected to increase at a slower rate in the 1990s than in the 1980s. Another argument for slowing growth is simply that incarceration rates are already at extremely high levels by historical standards, and, with an aging population, the rates seem unlikely to continue rising. Surveys also suggest that drug usage is down, indicating that, perhaps, drug arrests are also down.*

> *In summary, it is too early to tell with any certainty whether we are at a turning point with respect to inmate growth, or whether the recent lull is merely a temporary aberration in a continuing upward trend. Thus, the long-term outlook for spending on prisons is extremely uncertain.*

Prison Populations Continue To Grow: The growth of prison budgets is no mystery. Excluding capital outlays, prison budgets would be expected to grow by the combination of the national inflation rate (currently about 3%) and the percentage increase in the number of prisoners. The latest data on the increasing prison population shown below indicate national growth of 6.2%, which would make the expected corrections budget growth 9%. State corrections budgets don't grow at exactly the same rate as inflation plus prison counts. Growth can be slower if prisoners are crowded into existing facilities with existing guard staffing, but then shows sudden spurts as new institutions are opened.

At the end of 1991, there were 707,598 prisoners under the jurisdiction of state correctional authorities, an increase of 44,208 in one year. At a cost of $35,000 per prisoner year, the added cost of the 1991 increase in prison populations was $1.5 billion. At $50,000 per bed, the capital outlays to accommodate the increase would be another $2.2 billion.

Percentage Increase In Prison Population, 1990-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Rhode Island	15.9%	18	Maryland	8.1%	34	California	4.6%
2	Washington	14.5	19	Delaware	7.2	35	Connecticut	4.5
3	New Hampshire	14.2	20	Alabama	7.0	36	Iowa	4.5
4	Arkansas	13.9	21	Wisconsin	6.9	37	Nebraska	4.3
5	Idaho	12.7	22	Vermont	6.7	38	Oregon	4.1
6	Ohio	12.3	23	Virginia	6.6	39	Alaska	3.7
7	New Jersey	11.1	24	Maine	6.4	40	Montana	3.7
8	Tennessee	10.7	25	Michigan	6.3	41	Texas	3.3
9	Nevada	10.5		**United States**	**6.2**	42	Missouri	3.1
10	Louisiana	10.0	26	Hawaii	6.1	43	North Carolina	2.7
11	Massachusetts	9.5	27	Georgia	5.8	44	South Dakota	2.5
12	Minnesota	9.3	28	Illinois	5.8	45	Kansas	2.2
13	Oklahoma	8.9	29	South Carolina	5.7	46	Indiana	2.1
14	Colorado	8.8	30	New York	5.4	47	North Dakota	1.9
15	Kentucky	8.6	31	Utah	5.1	48	New Mexico	-2.1
16	Mississippi	8.3	32	Pennsylvania	4.9	49	West Virginia	-4.0
17	Arizona	8.1	33	Florida	4.8	50	Wyoming	-5.0

The wide range of these one-year changes shows state policy decisions at work. This is most obvious when states are compared with their neighbors, presumably subject to the same trends in crime and economic circumstances that might affect both the propensity to commit crime and the willingness to expand prison space. For example, **Ohio** increased its prison population by 12.3% while **Michigan** lived with 6.3%, about the national average, and **Indiana** held the increase to 2.1%. In New England, **Connecticut**'s increase was a below-average 4.5% and **Vermont** was at about the national average, but **New Hampshire** and **Rhode Island** showed increases above 14%. These differences are related to policy choices such as sentence length, use of probation as an alternative to incarceration, early release programs, time off for good behavior, and use of parole.

Impacts Of Growth: The implications of rapid inmate growth have been striking in **Washington**, which was second highest in prisoner growth in 1991. Prisons are now operating at 165% of design capacity. Prison population went above 10,000 in June. It is expected to rise above 14,000 sometime in 1996. A legal services group has sued the state seeking relief from crowded conditions. Construction of six new prisons was started last year. The corrections agency received an extra $10 million in its FY 1992 budget to accelerate opening these facilities and recently received $15 million in emergency funding.

This situation is a major turnaround. Five years ago, Washington was renting prison space to other states and was offered as a national model for controlling the growth of inmate populations. The Corrections Secretary suggests the choices are building yet more prisons or policy changes: "We really need to decide who we need to put in prison and for how long." He cites as an example a cocaine-addicted mother of six with no prior offenses convicted of a minor drug offense. She was sentenced to 27 months in prison, which he suggests may not be an appropriate use of state prison space.

Florida's corrections system has held its increase in inmates below the national average only by entering a spiral of problems so severe that they have received national attention (e.g., Newsweek, 5/18). Its financial constraints limit new construction, which doesn't matter in the short-term because operating budget constraints have prevented opening facilities already completed. A consent decree limits putting more prisoners into existing space. So Florida uses early release to make room for new prisoners. As a result, the typical prisoner sentenced for one year actually serves only three months.

Recognition of the short times actually served caused legislative reaction, so there are more mandatory sentences. Prosecutors reacted with greater use of habitual offender laws with mandatory sentences. As a result, the group not eligible for early release went from 15% of prisoners in the fall of 1990 to 40% in the spring of 1992. With the need for early release growing and the number of prisoners who can be released early decreasing, the average number of days taken off sentences rose from 70 days in March of 1991 to 295 days in February of 1992.

Incarceration Rates: Differing policies, rather than differing crime rates, are the best explanation for extraordinary differences in the ratio of prisoners to population. Those differences are particularly striking among nations. Counting prisoners held by all levels of government, the U.S. imprisons about 0.45% of its population, higher than any other industrial nation. Selected other nations in declining order: South Africa (0.31%), Canada (0.11%), United Kingdom (0.10%), France (0.08%), and Japan (0.04%). The state rates (excluding local jail inmates) are shown below as the incarceration rate, prisoners per 100,000 population.

Incarceration Rates, 1991

Rank	State	Rate	Rank	State	Rate	Rank	State	Rate
1	Nevada	477		**United States**	**310**	34	New Mexico	191
2	South Carolina	473	18	New Jersey	300	35	South Dakota	190
3	Louisiana	466	19	Texas	297	36	Washington	183
4	Oklahoma	414	20	Virginia	297	37	Montana	182
5	Arizona	398	21	Missouri	294	38	Hawaii	172
6	Alabama	392	22	North Carolina	270	39	Rhode Island	172
7	Michigan	387	23	Connecticut	262	40	Wisconsin	158
8	Maryland	366	24	Kentucky	261	41	Massachusetts	150
9	Florida	346	25	Colorado	247	42	Utah	149
10	Alaska	344	26	Illinois	246	43	Nebraska	146
11	Delaware	342	27	Kansas	230	44	Iowa	144
12	Georgia	342	28	Oregon	229	45	New Hampshire	132
13	Mississippi	335	29	Tennessee	227	46	Maine	127
14	Ohio	323	30	Indiana	226	47	Vermont	125
15	California	320	31	Wyoming	225	48	West Virginia	82
16	New York	319	32	Idaho	212	49	Minnesota	78
17	Arkansas	314	33	Pennsylvania	192	50	North Dakota	68

There are explanations for differences in the state rates. Crimes are primarily committed by those aged 18-35. But the denominator in the incarceration rate is total population. So states with low ratios of age 18-35 population to total population — like **North Dakota**, **Pennsylvania**, and **West Virginia** — tend to have low incarceration rates. Crime is also an urban phenomenon, with rural states tending to export their crime-prone youth. Criminals are locked up by the states whose laws they offend. The incarceration rate measures prisoners where they are held, not where they grew up. So states like **Maine**, **Vermont**, and **South Dakota** would be expected to have lower incarceration rates than states like **Massachusetts** and **New York**. Substantial tourism swells the ranks of potential victims and criminals without affecting the population denominator, so higher incarceration rates would be expected in **Florida** and **Nevada** than the industrial Midwest.

All this being said, there is substantial unexplained variation that can only be attributed to significant state policies. First, there is a systematic regional variation with Southeastern states showing incarceration rates well above the national average. Second, there is variation within regions. For example **North Carolina**'s rate is below the national average while **South Carolina** is second only to **Nevada**. The rate for seventh-ranked **Michigan** (387) is well above that of neighbors **Ohio** (#14 at 323), **Indiana** (#30 at 226), and **Wisconsin** (#40 at 158). The **North Dakota** rate is less than half of **South Dakota**.

These comparisons are easily translated into their financial implications. For example, by lowering its incarceration rate to the U.S. average, **South Carolina** could eliminate roughly 35% of its corrections operating budget and experience the nationwide growth in inmates for eight years without adding any new prison capacity.

Parole And Probation Increases: Probation (an alternative to prison sentences) and parole (release before the end of a sentence) are the primary mechanisms for retarding the flow of new prisoners and discharging prisoners faster. In 1990, only 14% of those leaving state prisons were released unconditionally as their sentences expired. The rest were released on fixed schedules with post-release supervision or, in the case of about 40% of releases, given parole at the discretion of parole agencies. While they are cost-saving in relation to prisons, probation and parole have substantial costs for supervision and reporting. The growth in these programs has been even faster than the growth of prison populations. From 1989 to 1990 (latest data) there was a 7% increase in the number of people under some form of correctional supervision — prisons, jails, probation, parole, and other programs. More than 3% of the nation's adult males are on probation or parole.

The variations among states are even more substantial for these programs than for persons in prison. The table (next page) shows for selected states: (1) the percentage change from 1989 to 1990 in the number of persons on probation and parole and (2) number of adults in each form of correctional supervision for every 100,000 adult residents, as of 1990.

Even though they deal with only a single year, these statistics show how state policies differ. **Rhode Island** and **Connecticut** are trying to avoid parole. Their parole rates are 80% below the national average and they cut the number of people on parole in 1990. Perhaps in reaction to treatment of prisoner release issues in the 1988 Presidential campaign, **Massachusetts** avoided the parole increase that would be expected to be associated with a larger prison population eligible for parole and dramatically reduced probation. The policies of Rhode Island were exactly reversed in **Oklahoma** which de-emphasized probation but sharply increased the use of parole, though still maintaining a parolee-population ratio of less than half the national average. In **Georgia**, the number of people on both probation and parole is about twice the national average, but in **Kentucky**, both are less than half the average.

Statistics on Probation And Parole, Selected States

State	Percent Increase, 1989-90 Probation	Percent Increase, 1989-90 Parole	Rate Per 100,000 Probation	Rate Per 100,000 Parole
United States	**5.9%**	**16.3%**	**1,443**	**287**
Massachusetts	-18.2	0.7	1,544	101
Delaware	26.0	26.7	2,430	255
Kentucky	-7.2	1.6	274	117
Georgia	7.7	29.9	2,838	477
Rhode Island	25.6	-18.3	1,975	41
Oklahoma	0.7	62.4	1,057	140
Connecticut	8.9	-9.6	1,838	11
Texas	5.9	20.2	2,538	903
California	7.5	17.5	1,389	307
New York	6.3	16.1	1,058	312
Illinois	1.9	21.5	1,128	208

Comparing Budget Increases: These striking comparisons of incarceration rates find little use in the politics of budgeting for corrections and even less in the cost-driving state decisions, like those on sentencing. They don't enter the state budget process at all. Instead, corrections policies enter the budget process on the politically sensitive point of comparisons with budget increases for education and other state functions. Two programs legislators don't point to with pride, corrections and Medicaid, have been achieving larger increases than other state programs, including education, for years. Part of the differential has been obscured for the public, and legislators themselves, by consistent underestimating of costs in these two programs. Much of the spending increases take the form of little-noticed supplemental appropriations.

This pattern has gone on for so long that it is now relatively well noticed by key legislators and interest groups. That factor and new tightness in state fiscal circumstances have motivated budget-oriented elected officials to take an increasing interest in controlling corrections costs, and thus examining what is driving incarceration rates and what, if anything, should be done about it.

Zero Defects And Willie Horton: There is no known way to prevent serious crime by accused felons awaiting trial but not in jail, by persons given a sentence of probation rather than prison time, by prisoners on work-release, and by former prisoners whose sentences have been shortened by good time or parole. Every one of these policies inherently carries the probability that innocent citizens will be murdered, robbed, and raped by persons who "should be in jail." The media coverage of these crimes need only report the event, the fact that the perpetrator "should be in jail or prison," and the outrage of the victim or victim's loved ones to set the stage for cries to end the programs and for later embarrassment of every state elected official associated with them.

This is often called the "Willie Horton factor" because of the use of one such incident in Massachusetts as an indictment of Governor Dukakis in the 1988 Presidential campaign.

> *These programs are clearly the right thing to do, no question. But I want to know what it will take to sell these programs because they might leave you open to political pot shots from people who would say you're soft on crime. I'm up for re-election this year, and Willie Horton is as well known in Rhode Island as is Michael Dukakis.* — Governor Sundlun quoted in the New York Times 8/7).

There are Willie Horton counterparts throughout the nation. For example, in **New Jersey** the new electronic surveillance procedure has about 633 participating inmates. They experienced a murder in April, followed by a beating and stabbing in May, followed by charges against a program participant for selling heroin from the apartment to which he was confined. The state senator in whose district the violence occurred called for suspension of the program. The Senate Law and Public Safety Committee held well-publicized hearings. The Corrections Department has put a planned expansion of the program on hold.

California legislators still talk about a 1980 victory by a 29-year-old unknown who upset a 22-year legislative veteran. He used a media campaign focusing on the incumbent's refusal to vote for increased penalties for repeat sex offenders like the East Area Rapist, who was never caught but was said to be responsible for 30 rapes in the district.

Varying Pressures For More Prisoners: The causes of increasing prison populations vary substantially among states, with an undercurrent of common reasons such as prison terms for drunk drivers. Part of the **Delaware** increase is associated with stiff sentences for first time drug offenders and a stricter definition of what constitutes a drug offense. Part of the problem in **Kansas** is a new parole board less willing to grant paroles. In **Massachusetts**, Governor Weld, a former prosecutor, has pushed for less leniency in the release of prisoners.

Crime Not Increasing

Since 1975, the Department of Justice has used surveys of households (the National Crime Victimization Survey) to determine how prevalent crime has become. The latest results show about 24% of U.S. households were victimized by crime in 1991, about the same as in 1990 and well below the 1975 rate of 32%. Considering only "crimes of high concern" (burglaries and violent crimes by strangers but not auto theft or crimes against other family members), the percentage of households affected dropped from 11% in 1981 to 7% in 1989 and has remained steady since.

The Outlook: The outcome of the current corrections controversies isn't easily predicted. Critics of high incarceration rates and ballooning corrections costs claim that states "can't build their way out of" the crowding of correctional institutions. Proponents of tougher sentencing either don't see the cost implications — and their implications for education, police protection, and other spending that might reduce crime — or take the view that corrections budgets should be whatever it takes to keep criminals off the streets.

Elected officials are looking for ways to satisfy both groups. This often leads to comments like one from Georgia's governor (City & State, 3/9): "We've got to have space available for major offenders, but we also realize that we cannot build our way out of our overcrowding crisis." It also leads to studies and task forces, such as one appointed by **Illinois**' governor this spring "to find innovative, cost-effective alternatives to building one prison after another."

One development may help relieve some of the current cost pressures. Court orders govern some prisons in 35-45 states, depending on who counts what. These are primarily consent decrees through which states have agreed to be subjected to court orders, and not the results of states losing litigation. Officials of some states appear to be taking a stronger stance against agreeing to such decrees. In January, the U.S. Justice Department — which has been a force in pushing such decrees in **California**, **Texas**, and other states — announced it would discontinue the policy except in extreme cases. The federal government, which runs prisons at 165% of capacity, will stop trying to enforce prison population limits on states, which overall operate at about 115% of capacity.

BUILT-IN STATE BUDGET DEFICITS

Are State Budgets Structurally Unbalanced?

Steven Gold (Director of the Center for the Study of the States) and Hal Hovey (**Reports** editor) have recently appeared together before several audiences discussing whether states face long-term structural deficits. This discussion is finding its way into secondary coverage, such as a lead article in City & State (8/10). If state structural deficits exist, important conclusions follow. First, by definition, current services (including adjustments for inflation and changes in workload such as the number of school children) cannot be maintained with taxes at current levels. Second, those who seek to maintain current services and particularly those seeking major cost-increasing initiatives (e.g., school finance equalization) should be backing ways to raise state revenues. Third, and conversely, those committed to holding the line on state taxes need to curtail current services. Fourth, because tax increases are never certain, those dependent on state funding can expect considerable uncertainty.

Minimum Conditions For Structural Balance

Gold and Hovey, along with most state officials, agree that state budgets in the aggregate will be out of balance unless two important conditions are fulfilled. First, the economy must show average annual growth in real gross domestic product of 2% or better, about the level being forecast for the 1990s. This is a somewhat slower growth rate than that of the 1980s for several reasons. The most important is an expected decline in the rate at which the number of American workers has been growing. In addition to demographic changes, the influx of women into the workforce has been going on for so long that future increases in labor force participation will be smaller than past ones.

Second, federal policy would need to: (1) avoid extensive new mandates and (2) continue current policy in grant programs. This includes inflation-matching growth in most programs and current matching ratios, without funding caps, in entitlement programs such as Food Stamps, AFDC, and Medicaid. There are many reasons to worry about federal policy in both areas. New mandates continue to be attractive to federal officials unable to stimulate state and local activity by new grant money. The new disability legislation, which is already the official federal reason for rejecting Oregon's health care initiative, is an example. Phased implementation of past mandates saved immediate fiscal impacts on state and local government, but means that mandates in pure drinking water, secondary and tertiary sewage treatment, and Medicaid coverage of young children, among others, have fiscal impacts yet to be felt. Current federal grant policy is clearly at risk from any serious attempt to balance the federal budget.

What Determines Structural Balance?

Assessing structural balance involves forecasting the relevant underlying economic and demographic trends. From these projections, revenues from existing sources at current rates and spending for current programs can be estimated and compared.

Revenues are usually related to personal income, with the basic relationships reasonably well known. Sales tax revenues will lag personal income growth because an increasing percentage of personal income is being spent on non-taxed services. Personal income tax revenues will grow faster than income because exemptions and deductions tend to be flat dollar amounts and many taxes have graduated rates. Over time, property taxes should rise with personal income as inflation affects both property and income in about the same way and population growth raises the stock of buildings as well as the number of workers. Excise taxes on volumes of cigarettes, alcoholic beverages, gasoline and other commodities and fixed fees for licenses will tend to lag inflation. When all this is added up, there is room for some difference of opinion, but state revenues probably tend to grow at about the same rate as personal income.

State and local government revenue growth may approximate personal income growth as well, particularly if assumptions about revenue include the concept that local fees — for garbage collection, water supply, sewage treatment, and other municipal utility charges — will reflect inflation.

Spending is subject to demographic trends. Some of these, such as the increasing number of elderly persons likely to seek nursing home care under Medicaid, are clearly unfavorable to state finances. The single most important demographic variable, the number of children at ages of school attendance, should be easy to predict as most of the children to be in school in the 1990s are already born. That trend is favorable to neutral. Enrollment growth of 1% or so means that the growth in the number of taxpaying workers will exceed the number of tax-consuming students, but by a lesser margin than in the 1980s.

"Technology," broadly defined, has mixed effects. Some technology, such as improved productivity of office machines, should have a favorable impact on government costs just as on private costs. Improved technology can increase health care costs, but also has had favorable impacts, such as reducing the costs of inpatient mental health care.

Structural Deficits And Policy Choices

Structural deficit projections implicitly contain definitions of policy choices. For example, the rising costs of public schools in the 1980s was heavily influenced by two trends: (1) a reduction in average class sizes, (2) extension of years spent in public school by (a) more widespread use of kindergarten, shifts to all-day kindergarten, and increased pre-kindergarten programs and (b) longer time in school by reducing dropout rates in the early years of secondary school. Costs of public schools have also been increased by defining an increasing number of students as requiring specialized services, particularly special education, with smaller class sizes. Depending on who does the projections, some continuation of these choices may be defined as part of state structural deficits.

In higher education, the dependence of costs on policy is even more direct. More students are attending college and staying there longer, with 4.5 years now the norm for undergraduate degrees. Higher education enrollment is clearly sensitive to state decisions, particularly those on scholarships, loans, tuition waivers, and tuition levels. By the same token, prison population change is a function of public policy on length of sentence, probation and other policies affecting the rate of admission to prisons, and work release, parole, and good time, affecting the rate of exit from prisons. While there is dispute over how large the effects may be, the welfare population is not independent of the level of welfare payments, the existence of work requirements, and job training programs. Medicaid participation is influenced by welfare eligibility requirements and state decisions on the services covered, as well as hard-to-measure differences in the ease of getting on Medicaid rolls.

Structural Deficit And Policy In California

Because the magnitudes of proposed changes are so large, the budget debate in **California** provides an unusual glimpse into the sensitivity of spending projections to policy choices. Already, the state has moved from a no-tuition policy for higher education to significant charges, still called fees. Further movement in this direction appears likely in the FY 1993 budget. It is already reflected in university plans even before a final budget is adopted. The impacts on enrollments are likely to be substantial -- discouraging attendance at residential universities relative to community colleges, discouraging part-time students with no degree objectives, and probably increasing percentages of students who choose private institutions for both vocational training and university work. Higher tuition may also cause students to complete fewer years than they would in a lower tuition environment.

There also is general agreement that California's welfare payment levels will be less generous than in the past and that work requirements will be strengthened. The governor has a proposal to alter enrollment in public schools by changing the age of admission to kindergarten. On the revenue side, Democrats in the legislature have been pushing a proposal to end the indexing of the personal income tax for inflation, a move that would significantly increase the change in receipts relative to the change in taxable income.

Structural Deficits In Individual States

The attempts to calculate current service balances, whether deficit or surplus, for states in the aggregate conceal the fact that few states have a nationally average combination of revenue structures, demographic trends affecting spending, and fiscal legacies.

Revenue structures that automatically cause revenues to rise faster than personal income help avoid structural deficits. Examples are graduated income taxes without indexing, property taxes with non-indexed homestead exemptions, sales taxes that capture a large portion of growing service business, income taxes that capture Social Security and pension benefits, and excise taxes and fees indexed for inflation. **Hawaii** and **Minnesota** have such tax systems. States with no personal income tax, sales taxes without much coverage of services, non-indexed excise taxes and fees, and high reliance on severance taxes tend to have structural deficits. Examples are **Florida**, **Nevada**, **New Hampshire**, and **Texas.**

Demographic trends involving little or no growth in school age populations are favorable to avoiding structural deficits. Nearly all the states in the Northeast and Midwest are examples. Conversely, Southeastern and Western states, particularly **Utah**, face rapidly growing enrollments.

The worst examples are **California** and **Florida**, where this year's budget issues have centered on whether to increase school aid enough to cover the combination of inflation and enrollment growth. Florida did not provide such an increase, despite a tax increase. California's budget delay is largely attributable to a determination to provide roughly this level of increase (which is mandated by Proposition 98) *and* avoid a tax increase.

Fiscal legacies are the impacts of past fiscal practices on current and future spending. Taxpayers of some states face negative legacies associated with high debt (e.g., **New York**) and underfunded pension plans (e.g., **Massachusetts** and **West Virginia**). With traditions of no short term borrowing, pay-as-you-go financing of capital outlays, and well-funded pension plans, Southeastern and Midwestern farm states tend to be in much better shape. States like **Texas**, **Wyoming**, and particularly **Alaska** have vast reserves in permanent funds.

Commitments, Court Orders, And Structural Imbalances

Structural imbalances are defined locally by differing ground rules. The most significant differences between individual state practices and the current service definitions used in national studies concern inflation, commitments by elected officials, and "uncontrollable" expenses imposed by forces outside the governor and legislatures.

Inflation adjustments are routine in national studies, but not made in current projections of some states. As a result, state employee salary increases are viewed as additions along with such other budget factors as cost-of-living increases for retired workers, reimbursement rates for foster parents and other providers of service, and welfare payment adjustments. Particularly in **California**, such adjustments are built into permanent law as well as in budget projections.

Commitments are made by legislatures and governors in many ways, most significantly in legislation that promises future increases in spending (e.g., school aid formulas with multi-year cost escalation as in **Colorado**) or reductions in taxes (e.g., temporary increases this year in **Rhode Island** and **Vermont**). Because state budget projections assume existing law, locally defined "structural imbalances" are inherent in budget of states like **Louisiana** (which raises much of its revenue from a "temporary" suspension of sales tax exemptions) and **New York** (which has an oft-postponed schedule of phased reductions in personal income taxes). Such commitments are routinely ignored in national projections examining whether there is a structural deficit in state and local finances.

Uncontrollable expenses are defined quite differently from state to state, with contractually committed debt service the only common element.

Some states have, in effect, allowed their corrections, mental health, child welfare, and/or mental retardation agencies to turn their budget aspirations into consent decrees of federal courts. Some states turn court-ordered school finance equalization (requiring equal spending, not high spending) into typical equalization plans which achieve equalization only by increasing aid, not by offsetting increases and decreases. With both these situations, the **Texas** budget easily gives rise to the conclusion that it is structurally out of balance. Constitutional mandates of school funding increases in **California** and **Louisiana** are extreme examples of restrictions leading to imbalance. Measure 5 in **Oregon** and a November ballot measure in **Michigan** (both mandating property tax rollbacks with the state making up lost local revenue) are also extreme examples.

Shots In The Fiscal Foot, Imbalance In FY 1994

In the last few months, there has been a surge of discussion about budget balancing problems for FY 1994. **Montana** legislators concluded their recent special session with bipartisan agreement that their solutions weren't permanent. These included accruing unreceived revenues and delaying school aid payments. **Washington**'s retiring governor warned that the legislature successfully got out of town this year only by leaving a major imbalance for the next biennium. In states with significant reserves, like **Indiana** and **Minnesota**, use of reserves to finance this year's spending raises the question of how to pay for next year's.

Vermont is a good example of creating future problems. By running deficits and covering costs with borrowing, the state has $65.5 million in debt to pay while its "temporary" taxes are scheduled to expire. **Maine** has a worrisome collection of problems to face in its new biennial budget to be considered next year: (1) loss of over $250 million in revenues from temporary tax increases, (2) a $40 million pay hike already adopted combined with the loss of furlough days that offset its costs, (3) the scheduled expiration in June of a pay cut associated with shorter employee work-weeks, (4) a postponed $70 million payment to the retirement system, (5) replacing one-time revenue from accelerated tax collections, and (6) using borrowed funds to make a debt service payment.

While some state officials may choose to consider these situations as indicative of structural imbalance, they are phenomena associated with this year's high propensity of state officials to avoid tough choices like spending cuts and tax increases.

Assessing Fiscal Stress, FY 1991

Gold used statistics on state economies, like the Index of State Economic Momentum and its components, and information about state budgets, like reported balances, to construct a fiscal stress index for FY 1991. The results are on the table.

Fiscal Stress Rankings, FY 1991 (Largest Rank Number = Most Stress)

Rank	State	Rank	State	Rank	State	Rank	State
1	Oregon	14	West Virginia	27	Indiana	39	Pennsylvania
2	Nevada	15	New Mexico	28	Illinois	40	Maine
3	Washington	16	Kentucky	29	Alabama	41	Michigan
4	Montana	17	Louisiana	30	Delaware	42	Vermont
5	Nebraska	18	Texas	31	Tennessee	43	California
6	Alaska	19	Kansas	32	Ohio	44	New York
7	South Dakota	20	Arkansas	33	Florida	45	Maryland
8	North Dakota	21	Colorado	34	New Jersey	46	Virginia
9	Hawaii	22	Wisconsin	35	South Carolina	47	Massachusetts
10	Utah	23	Minnesota	36	North Carolina	48	Connecticut
11	Wyoming	24	Arizona	37	Georgia	49	Rhode Island
12	Oklahoma	25	Iowa	38	Missouri	50	New Hampshire
13	Idaho	26	Mississippi				

Gold's index, the Economic Momentum Index, and single data series like the employment changes presented elsewhere in this issue can provide significant insights into state fiscal problems and likely actions. But they inherently rely on data, which means they are backward looking. Gold's index cannot yet be updated for FY 1992, but most state officials are now arguing about their concerns for FY 1994.

Fixing Fiscal Balance: The joys of having a structurally balanced budget, even if it is subject to deficits in recession and surpluses in recovery, were articulately presented in a recent report on New York City finances:

> *A structurally balanced financial plan permits stabilizing service delivery and thereby anticipating employment needs better so that expansion and contraction in agency staffing can be accommodated as completely as feasible through attrition and voluntary transfers. Hiring in one year to be reversed the next year with freezes or layoffs is minimized, because the structure of expenditures that led to the hiring is sustainable over time. Service recipients value this stability because service delivery is more reliable from year to year and, indeed, within a year. Organized labor values it because layoffs are avoided and evolving manpower needs are handled by managed attribution, which is least disruptive to union members. Managers also favor this stability, which allows them to develop staff and to focus their time less on budget changes and more on improving service delivery without raising costs. The business sector favors structural stability because it gives businesses predictable tax and service policies that are necessary for effective business planning. Other taxpayers favor it because they can reliably know their tax obligations and the services that they can expect from government.*

> *Another benefit of structural balance is that priorities created in one year's budget are sustainable so that agencies can reasonably plan service demands and manpower needs over a multi-year period. Program reversals, and the sizable inefficiencies they create, are minimized. The enhanced ability to sustain priorities and to maintain stable service delivery permits substantially increased focus on the purpose and mission of agencies and on the ability of the budget to accomplish that mission. Without reasonable year-to-year stability, repetitive budget-cutting exercises occur under relatively short time frames, which permit little opportunity to design expenditure reductions that achieve the necessary savings and at the same time preserve the top priorities and mission of the agencies.*
>
> *Without structural balance, there can be little assurance that spending cuts can be restored in the next several years or that temporary tax increases may expire. In contrast, if the financial plan were structurally balanced, one could have realistic expectations whether certain cuts were permanent components of restructuring finances or were merely temporary steps to weather a severe recession. Because structurally balanced budgets may still have deficits during economic recessions, spending reductions or tax increases will still need to occur, but will be temporary or transitional until the economy recovers and budget surpluses emerge.*

ECONOMIC DEVELOPMENT STRATEGIES

State competition for new factory and office locations remains intense, more restrained by the lack of new investments to finance than by state and local reluctance to provide tax concessions, sites, infrastructure, worker training, and other incentives. The latest big deal is BMW's new plant in **South Carolina**. The state's incentives, which Business Week (7/6) called "a cumulative $135 million bonanza," include a 900-1,200 acre site and infrastructure improvements on and around the site. According to the New York Times (6/23), the incentives were $145 million, not including the state's current tax credit for employment expansion and a concession on water and sewer costs. Many states joined the early competition for the plant, with **Nebraska** apparently the runner-up.

South Carolina has enjoyed considerable success in attracting foreign manufacturing investments in the past two decades, including Michelin (French tire company) which now has four plants and 5,400 workers in the state. German auto manufacturers, unlike Japanese car builders, don't have much of a track record in the U.S. Volkswagen, with state subsidies that were the precursor of the present auto deals, opened a major facility in **Pennsylvania** that closed after a decade of high costs, low sales, and quality control problems.

Localized cross border wars over development continue in many areas. Examples are the competition between **New York** and **New Jersey** for office workers, an intensively hot competition between **Ohio** and **Kentucky** for manufacturing in the Cincinnati area, and the continuing competition between **South Dakota** and **Minnesota** for any kind of development.

States continue to compete in finding export opportunities as well as attracting foreign investment. According to a survey by the National Governors' Association, states spent nearly $100 million on international operations in 1991, including the 41 states that maintain 163 offices in 26 different countries and 27 governors that made 29 trips to 21 different countries. NGA figures show that states spent $211 million on tourism promotion in 1991, over ten times federal spending for tourism.

States are extending their activities to encourage successes by home-state firms as well as encouraging newcomers. There are new general incentives in state tax revisions this year, like R&D and employment expansion credits in **Connecticut**. A new report indicated that 28 states now have substantial technical assistance activities known as industrial extension programs. There is a continuing pattern of special exemptions designed to lure particular firms.

However, there are signs of trouble on the smokestack chasing front. The normal ebb and flow of business success and failure, exacerbated by recession, have left many local governments with the bill, but without the benefits, of subsidized development. Aircraft manufacturer McDonnell Douglas, which excited many states with prospects of a new plant, recently announced cutbacks and closing of its facilities in Columbus, Ohio. Northwest Airlines, which nabbed a big subsidy commitment from **Minnesota**, is in financial trouble. Its construction of a maintenance base in Duluth is behind schedule and may be further delayed by litigation over the constitutionality of the state's contribution.

The supercollider, being built in **Texas** with large state subsidies, has encountered difficulties in federal funding. The package of industrial development tax incentives proposed by Governor Weld was nixed by the **Massachusetts** legislature, which opted for spending and an estate tax cut instead. Business protests that the environment for development was being spoiled by high taxes didn't convince **Pennsylvania** legislators to roll back last year's sharp increase in corporate income taxes, nor prevent **Rhode Island** from continuing its "temporary" corporate income tax surcharge or broadening its sales tax base to include some business services.

One significant, but quiet, development was the halt to unbridled tax abatements enacted in **Alabama** this year. It was the only piece of a tax and spending reform package of over 20 bills that made it through the legislature.

The Tax Incentive Reform Act limits the term of abatements (10 years or, if less, the expected life of the property), eliminates them for taxes used to finance education, and requires a separate application including projections of employment gains. Abatements had been a semi-automatic corollary of decisions to finance through tax-exempt revenue bonds. "Private use property," such as city and county land leased for nominal prices for company plants and industrial parks is subjected to new reporting requirements that will indicate the tax losses involved, though not directly curtail them.

When beneficiaries of tax abatements and even state subsidies fail to perform as promised, state and local governments rarely recover their out-of-pocket costs, though they keep what they own (e.g., improved sites and nearby infrastructure investments). One major reason is that contracts either are not involved at all or don't hold developers to either employment increase commitments or payment of specified damages. Nonetheless some jurisdictions are suing for unfulfilled development promises.

Kansas City has sued developers who opted out of a rail station renovation. Most of the $91 million in claims have been rejected in trial court. The city is seeking the remaining $13 million for property tax revenue on office buildings that were built using tax abatements and a road project the developer agreed to finance but didn't.

JOB GROWTH AND DECLINE

The state-by-state employment data released in July suggest total national employment dropped by 448,600 between May of 1990 and May of 1991. The nationwide job loss of 0.4% indicates continuing economic problems. However, it is less than the one-year losses earlier this year and last year, confirming other national data suggesting the recession has bottomed out. Individual states show great variation as shown by the table (next page).

The most striking news is the concentration of the job losses. **California** lost 202,600 jobs in the year, followed by major losses in **New York** (191,200), **New Jersey** (110,300), **Pennsylvania** (64,000), **Massachusetts** (53,500), **Connecticut** (52,600), and **Maryland** (50,500). These states and two smaller Eastern states — **Rhode Island** (8,700) and **Delaware** (6,300) — are the largest percentage losers shown on the table.

Job gains were less concentrated than job losses. Despite a national job loss, 29 states reported gains. The largest single gain was in **Texas** (80,600 jobs), followed by **Arkansas** (28,500), **Indiana** (28,300), and **Minnesota** (25,100).

Percentage Change In Employment, May 1991 to May 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	3.11%	18	Washington	0.85%	35	Illinois	-0.39%
2	Arkansas	3.10	19	Kentucky	0.76	36	Virginia	-0.40
3	Utah	2.64	20	Alaska	0.65		**United States**	**-0.41**
4	Nevada	2.37	21	North Carolina	0.56	37	Ohio	-0.54
5	West Virginia	2.09	22	Wyoming	0.53	38	Florida	-0.66
6	South Dakota	2.07	23	New Mexico	0.51	39	New Hampshire	-0.88
7	Kansas	2.07	24	Nebraska	0.46	40	Vermont	-1.01
8	North Dakota	1.98	25	Alabama	0.44	41	Pennsylvania	-1.25
9	Oregon	1.72	26	Iowa	0.34	42	South Carolina	-1.51
10	Montana	1.65	27	Georgia	0.30	43	California	-1.62
11	Colorado	1.63	28	Arizona	0.20	44	Delaware	-1.82
12	Wisconsin	1.24	29	Tennessee	0.20	45	Massachusetts	-1.89
13	Minnesota	1.17	30	Louisiana	-0.07	46	Rhode Island	-2.04
14	Indiana	1.13	31	Oklahoma	-0.16	47	Maryland	-2.39
15	Texas	1.12	32	Michigan	-0.26	48	New York	-2.41
16	Mississippi	0.94	33	Maine	-0.29	49	New Jersey	-3.14
17	Hawaii	0.93	34	Missouri	-0.30	50	Connecticut	-3.36

There is no correlation between this current indicator of state economic indications and tax actions taken in 1992. Tax cuts were concentrated in poorly performing states such as **Massachusetts**, **New Jersey**, and **Pennsylvania**, though other poorly performing states (**Florida**, **Maryland**, and **Rhode Island**) raised taxes. Some of the best performing states (e.g., **Colorado**, **Kansas**, and **Montana**) also raised taxes. Considerable bad news is already reflected in the budgets enacted in **Connecticut** and **Rhode Island** and is reflected in the continuing budget deliberations in **California**. The other states on the bottom of the table may have bad fiscal news to come. **Maryland** is already reporting shortfalls.

TOTAL QUALITY MANAGEMENT

With the governor's leadership in total quality management, this is the time to rethink and retool our fundamental approaches to management and leadership. — Texas Mental Health And Mental Retardation Director quoted in Austin American-Statesman (7/28).

We don't have anything to do with the MHMR program. — Texas governor's press secretary quoted in Austin American-Statesman (7/28).

Controversy over spending about $1 million on Total Quality Management (TQM) programs in one **Texas** agency is indicative of controversy across the country about the value of the newest trend in private and public sector management. The issue broke into the Texas press when the mental health agency announced it was spending over $200,000 (not counting staff time) to provide statewide taped seminars by W. Edwards Deming, the guru of the TQM movement, as part of its new management approach. Critics contended the agency should be spending its money on improving patient care.

The Texas agency isn't alone in its interest in TQM and related approaches. The Federation of Tax Administrator's meeting this summer featured presentations on state tax agency use of TQM in **Minnesota** and **Wisconsin** and a **Colorado** Department of Revenue paper on "Use of Private Sector Principles of Sound Management." The American Association for Higher Education has started an "Academic Quality Consortium" to bring together universities for information exchange about TQM. The one sentence appraisal by the Chronicle of Higher Education (8/12) illustrates controversy in all state operations over whether the approach is new or helpful:

> *Across the country, colleges and universities report success with the technique, even though some skeptics say Total Quality Management is just the latest jargon for the kind of collaboration and shared governance that many colleges and universities have long practiced.*

The quality management issue was debated at a full day seminar at the NCSL meeting in July. Other NCSL sessions also highlighted the concept of TQM and the book by David Osborne, Reinventing Government. Speakers, as well as those in the audience, varied in their enthusiasm. One told legislators that they are "going to have to get into this" and promised the TQM approach would help legislators "regain citizen trust." She described the process of getting state managers to adopt TQM principles as like religious conversion.

Another TQM advocate criticized standard state "one-size-fits-all" policy approaches and said they could be replaced by "high quality customized services." He stressed concepts of empowering consumers of government services and leveraging private sector resources through state programs. He contrasted TQM's approach of doing without bureaucracy and employing social contracts with service recipients with the liberals' approach of giving bureaucracy more power and the conservatives' approach of reducing government power.

One particularly enthusiastic TQM proponent promised the possibility that "Costs will be down, budgets will be balanced." A handout on the State of **Colorado** program boasted of "improved the way things get done," "fewer errors," "less wasted effort," "better service at lower cost," and "increased satisfaction among state citizens."

NCSL executive director William Pound said changing fiscal circumstances mean states and legislators "have entered a different time." In that context, he contrasted the management approach of TQM with the traditional function of legislators, passing bills. He concluded that legislators might have to improve several functions that some tend to do poorly: planning (citing **Kentucky** and **Florida** as examples of what can be done in legislatures) and legislative oversight. Rich Jones (NCSL staff) said legislators could gain from "results-oriented government." But he warned that the precise definition of goals urged in TQM and other approaches wasn't easy because legislation often embodied compromises that retained differing goals of members voting for approval. He and Hal Hovey (**Reports** editor) pointed out many similarities between the currently popular TQM and other approaches that have had their days in the sun — sunset laws, cost-effectiveness analysis, planning-programming-budgeting systems, cost-benefit analysis, management by objectives, and strategic planning.

Hovey suggested that one reason for the popularity of ever-changing management concepts embodying similar approaches was that the changes allowed new people to exercise leadership and encouraged rethinking of government functions and ways of operating — "getting dead policies and dead people out of power." He suggested that those seeking to change what is done would be well advised to seize whatever new vocabulary was most popular for their advocacy of previously considered positions as well as seizing whatever new insights they might develop from the new approaches.

A recent report from the Rhode Island Public Expenditure Council shows that this is already being done. Rethinking Government — Making It Work is a melding of approaches. It starts with current concerns about state government that serve as motivation — tax and fee increases, reduced school funding, deferrals of spending, and a public opinion poll showing most Rhode Island voters believe the state is headed in the wrong direction. Recognizing government roles in education, transportation, protecting the environment, and creating a climate for economic prosperity, it concludes, "If Rhode Island is to flourish, its governments must succeed."

Two Management Approaches Enacted

Contrasting styles for legislation to improve management are illustrated by two recent enactments. **Tennessee** bought into TQM with the "State Government Quality Improvement Act of 1992." It endorsees the principles and sets up a task force to encourage their implementation. **Ohio**'s governor recently signed a bill implementing 23 of the recommendations of the business-oriented Operations Improvement Task Force. The group made 1,467 recommendations (only 125 requiring legislative action) that are heavily oriented toward specifics like those addressed in the bill — notifying by cheaper methods than registered mail, capturing welfare overpayments from tax refunds, and more use of halfway houses for prisoners in the last 120 days of their sentence.

The Rhode Island report cites concerns common to all states, asking: (1) How can policy be more investment oriented, dealing with early childhood programs, worker training, and infrastructure? (2) How can more emphasis be placed on self-sufficiency rather than income maintenance? (3) Can the state afford not to attack root causes of crime rather than incarcerate criminals at $30,000 per year each? and (4) What should be the priority and funding mechanism for health care?

After suggesting a revitalized state government should be "customer-driven, user-friendly, knowledge-based, results-oriented, accountable, and flexible," the report moves to specifics. Those specifics— drawn from past reports of blue ribbon groups, the council, and others — include some old standbys like reorganization of state government, sorting out state and local government roles, a management information system, personnel reform, linking budgeting and policy development, and having four-year terms for the governor.

MISCELLANY

Budget Wrap-Up

In Issue 15, three states that hadn't finished budget deliberations were listed as possibly facing major fiscal problems next year if they opted not to deal with them in their FY 1993 budgets. **Michigan** adopted a budget well before the October beginning of the fiscal year that doesn't raise taxes, but does leave problems for next year. Those problems will be exacerbated if the governor's "cut and cap" property tax relief measure is adopted by voters in November. Much of the planned state revenue growth would be used to compensate for the school property tax cut while considerable local revenue growth will be cut off by the cap. **Rhode Island**, where the budget was delayed until after July 1 by an unrelated water supply issue, bit the bullet with a combination of spending cuts and tax increases. **California** is moving toward a resolution involving less money for universities than last year, welfare payment cuts and eligibility restrictions, sharp cuts in state operations (e.g., parks and recreation), and shifts of state financial pressures to local governments, which may get new taxing authority to deal with them.

Privatization

As **Reports** periodically points out, the subject of *privatization* is producing much talk but little activity in such obviously privatizable areas as state operation of liquor stores and insurance funds. Part of the reason is that privatization advocates tend to be doctrinaire on the inherent superiority of private over public operations, to work poorly or not at all with public employee unions, and to tackle politically tough cases (e.g., vouchers for private schools and contracting out prisons).

The major steps in moving functions to the private sector are being made where privatization isn't the issue -- substitution of community mental health for state institutions for therapeutic reasons and shifting publicly operated hospitals to the not-for-profit sector to improve access to Medicaid and insurance reimbursements.

While some **Michigan** elected officials have sounded doctrinaire on the subject, Michigan's current approach to the subject (which acknowledges debts to the State of **Georgia**) is clearly pragmatic. The governor has asked a seven-member group (including state and private sector management and labor) to assess a new 62-page report on privatization opportunities. The report considers where privatization may be appropriate and inappropriate and provides detailed lists of functions that should be considered for privatization. Contracting out corrections functions entirely and school voucher plans are notably absent from the lists, which concentrate on functions which have private sector counterparts.

The report will probably draw criticism because it isn't symmetrical — there is no review of functions done privately that might be shifted to the state to match the list where the reverse is being considered. But privatization critics will find considerable solace in the circumstances under which the report suggests the state shouldn't privatize:

> The task is uncertain at the outset and prone to revision.
>
> The value of the production is hard to measure.
>
> It is very disruptive to switch contractors in mid-stream.
>
> The unit of government knows the best means to accomplish the task.
>
> Process is as important as the end result.

TECHNICAL NOTES

Prisoners: The periodic reports on corrections populations come from the U.S. Department of Justice. The state data shown come from its publication Prisoners In 1991, which includes federal prisoners (less than 10% of the total, not enough to distort state comparisons) and excludes local jail populations except when state authorities lease local jail space for state prisoners. The $35,000 cost of a prisoner-year used in the text is substantially above the numbers most often used, which are more like $25,000. Those statistics come from correctional agencies, which fail to include massive centrally budgeted costs including their own agency overheads, state overheads (e.g., state personnel departments, attorney general personnel used to defend corrections officers), and centrally budgeted state costs which often include tort claims payments and employee life insurance and sometimes health insurance, pension contribution, and more.

For state-by-state data on changes from 1980 to 1990 in prisoner counts and state spending, see Sarah Ritchie, The Growing Problem Of Corrections For American States (Center for the Study of the States, 411 State St., Albany, NY 12203). The data on probation and parole come from the Justice Department publication Probation And Parole 1990. Data on crime rates and additional corrections statistics will be found in States In Profile.

Structural Deficits: The most articulate presentation of the perspective that state and local governments have built-in deficits appears in Steven Gold's book (published by the National Conference of State Legislatures in 1989), The State Fiscal Agenda For The 1990s. The view that there is a structural surplus appears in the 1986 U.S. Treasury Department study, Federal-State-Local Fiscal Relations. For the perspective that, with the right assumptions and some effort, state and local governments in the aggregate can provide current services with current revenues, see Harold A. Hovey, "Who Pays When State Health Care Costs Rise?" in U.S. Advisory Committee on Social Security, State Governments: The Effects Of Health Care Program Expansion In A Period Of Fiscal Stress (1991). Gold's stress index appears in State Tax Notes (8/3). The long quote on the benefits of structural balance is from the agency that oversees New York City finances (New York State Financial Control Board, Structural Balance, July).

Economic Development: NGA's statistics on foreign commerce promotion were presented by press release (5/21). Its 81-page report, Increasing The Competitiveness Of America's Manufacturers: A Review Of State Industrial Extension Programs, was released in June.

Quality Management: NCSL has arranged for tapes of most of its annual meeting sessions. NCSL staff members who arrange the sessions are good sources of information on what materials were presented and which experts seem knowledgeable about what. Perusal of shelves at any business-oriented bookstore or the pages of business journals will provide an introduction to TQM concepts. The Rhode Island Public Expenditure Council (300 Richmond St., Providence, RI 02903), which issued its report in late July, is a private nonprofit group oriented to state management and finances that is funded primarily by businesses active in Rhode Island.

A must-read for those interested in varying government-wide management approaches in the states is Recent State Government Reorganization, Productivity, And Management Improvement Efforts (Revised edition, July 1992). This 50-state summary was presented by Frank Mauro (Deputy Director, Nelson Rockefeller Institute of Government) at the NCSL meeting and is available from the Institute (State University of New York, 411 State St., Albany, NY 12203).

Privatization: The Michigan report was published as a draft by the Department of Management and Budget (P.O. Box 30026, Lansing, Michigan 48909) as Privatization In Michigan: Recommendations To The Governor.

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VOLUME 10 ISSUE 17

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California now has a budget, but hasn't solved its budget problem. Its action concludes an unhappy year for legislators, governors, state employees, and voters.

- What An Awful Year p. 2

Dissatisfaction with finances has drawn new attention to the process for making budget decisions. Budget reform's popularity may have some justification, but it won't solve concerns of those who want to spend more and tax less.

- Reforming The State Budget Process p. 8

States have been struggling to put enough new money into schools to cover enrollment growth and inflation, with success mostly in tax-raising states. Success in education quality is also proving elusive.

- Financing And Reforming Schools p. 13

About half the states are in litigation over financing schools. The threat of litigation is leading to changes even where no cases are in the courts. Cases may become more complex as plaintiffs look to settle adequacy of funding, not just equality of funding, through lawsuits.

- School Finance Litigation p. 15

Recent national projections of school enrollment and problems in making current estimates and projections of population suggest such estimates need to be used with caution.

- Enrollment And Population Estimates p. 18

Miscellany covers deficits, litigation affecting states, and how much states pay nursing homes. Technical notes detail sources and caveats.

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STATE POLICY REPORTS

September 1992 (First Of Two September Issues)

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WHAT AN AWFUL YEAR

Introduction, California And The Nation

California completed action on the FY 1993 budget in early September. The much-delayed resolution of its budget issues completes state approvals of current year budgets and marks the end of most state legislative sessions for this year. The Golden State's action adds an unpleasant final chapter to stories from 49 other states.

This article, the summary chapter, concludes that it wasn't a good year from any perspective. In fact — from the perspective of liberals or conservatives, Republicans or Democrats, those concerned with good politics (in the sense of keeping incumbents re-electable), or good government (however defined) — it was the worst year since **State Policy Reports** began chronicling state policies ten years ago.

This article summarizes activity across all state policy fields and across all 50 states, using California's budget resolution for illustrations.

California is by no means unique in leaving many fiscal and other problems unresolved. In late August, **Texas** legislative leaders and the governor issued a joint warning to agency heads suggesting a $5 billion deficit if current policies were continued.

> *While Texas state government will have more money to spend in the 1994-95 biennium than what was budgeted for 1992-93, that growth will fall far short of paying for a traditional current services budget.... Lawsuits, court orders, unfunded federal mandates and constitutionally restricted funds continue to fuel spiraling demands on our limited state funds.... {To balance the budget, we must} go far beyond where we can eliminate waste or fat. We may have to downsize agencies, reduce responsibilities and eliminate services.*

Morale And Job Satisfaction

Worrying about how state workers feel about their jobs is not the subject foremost on the minds of the voters. Nevertheless, reasonably high morale is one sign of an effective organization. It is universally cited in the currently popular management literature, though often as a part of concepts like "corporate culture." Morale isn't easy to measure, but the impressionistic evidence is strong that state employees, from elected officials to the service deliverers, are not feeling good about their work.

Legislators Unhappy

The signs of low morale are clearest among legislators. Grousing by experienced legislators about how bad the last session was, though not quantifiable, is probably at record levels. Turnover among legislators between 1992 and 1993 will likely set new records. Polls indicate that the job of being a legislator is more thankless than usual, with anti-incumbent sentiment at all time highs. In many states, legislators are working harder and getting less done. **California** is the best example. The two extra months of budget deliberation didn't produce a budget, or other legislation, that many legislators would like to characterize as outstanding or even above average.

Other legislators have had extraordinary workloads with little to show for it. **Texas** legislators are theoretically in session once every two years, but have participated in many special sessions over the last two years. The main reason was to solve the school financing crisis. But after all their work, that situation is as bad as it can get. The school finance arrangement that resulted from all the changes has been declared unconstitutional by the state's highest court. The property tax that is its cornerstone is being collected despite a decision, not subject to being appealed, that it is unconstitutional, and a deadline of next summer for its correction.

There are other examples: **Alabama** legislators spent most of the year on tax and education reform. They have nothing to show for it except a well-based fear that much of the current tax system (e.g., insurance, solid waste disposal fees, and franchise tax) is in violation of the commerce clause of the U.S. Constitution. Appropriations in the enacted budget are being pro-rata reduced with consequences such as laying off corrections officers in the face of rising prison populations. In **Florida** and **Tennessee**, acrimonious and long debates over spending levels and tax reform ended with little or no reform, enough tax increases to discourage those interested in holding the fiscal line, and too little spending to come close to satisfying the aspirations of those interested in expanded state services. **Nebraska** legislators have spent nearly two years with the substantively and politically difficult problem of salvaging their property tax system.

Governors Unhappy

It hasn't been a good year for governors either. They have made little headway on such important agenda items as health care financing, education reform, and attempts to reduce welfare dependency. The decision by many governors to descend upon Congress to seek relief from federal preemptive legislation in health care demonstrates an increasing recognition that progress on that front is blocked by forces beyond the control of governors. Progress on other fronts has been stalled by combinations of state fiscal problems and economic stagnation, making progress in ending welfare dependency and funding health care difficult.

Governors' fiscal problems, intrinsically serious, became more frustrating for many of them because they often resulted in long confrontations with legislative majorities rejecting the premise of the governor's approach. While this didn't happen in all states, it happened regardless of the fiscal approach taken. Governors Chiles in **Florida** and McWherter in **Tennessee** pushed hard for higher spending and major tax increases, but didn't get them. Governor Florio of **New Jersey** unsuccessfully sought an austere budget with no tax increases, but got what he considers an untenable budget with a tax cut instead.

Governors seeking to hold the line on taxes with deep spending cuts got half a loaf in states like **California** and **Michigan**. Governor Weld got much of the austerity he sought, but none of his tax cut agenda for **Massachusetts**. The new **Mississippi** governor was elected after a campaign against higher spending and taxes, but saw a sales tax increase passed over his veto.

Even governors seeking to deal with fiscal problems by combinations of relatively mild spending cuts and relatively mild tax increases hit problems typified by those of **Illinois** and **Ohio**. Fiscal issues dominated the legislative sessions, as legislators were uncomfortable with both any form of tax increase and with proposed spending cuts.

Having one of the best fiscal situations in the nation didn't help either. Governor Gardner of **Washington** is leaving office after two terms of watching his reform proposals fail in the legislature. He says the state's finances are now in bad shape and that neither candidate for his job is facing up to the problem.

Employees Unhappy

State employees have been operating under the shadow of the budget ax nearly everywhere. **California** employees have been getting their pay in script while waiting to see what form the now-adopted pay cut would take. Hiring freezes, promotion freezes, and pay freezes have been common. Layoffs have been more announced than implemented, but the impact on morale is more often associated with announcements than final action.

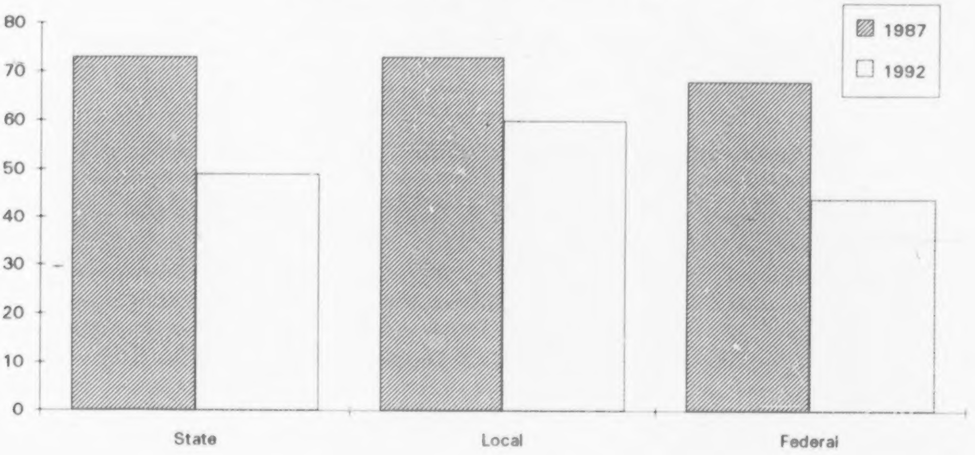
The major 1991 tax hikes in **California**, **Connecticut**, and **Pennsylvania** didn't avoid pressures on pay and job security the following year. The story is no more encouraging from **New Jersey**'s 1990 increase, or from the large increase this year in **Maryland**, which has proven insufficient to fund the enacted appropriations. Improvements in state finances aren't always reaching employees. In **Massachusetts**, there haven't been pay raises for some employees in four years, as tax-cutting became this year's priority for state spending and contributing to anything but teacher pay increases became the priority for new state school aid funds.

Customers Unhappy

State employees, from janitors to governors, always feel they are under appreciated by the users of state services. There is probably more justification than ever for such a view. Few state officials are likely to claim improvements over the past year in such fields as social services, university education, and health services. Many state employees in these areas are loudly proclaiming they aren't able to maintain past standards of service.

A recent national poll shows the erosion of confidence in all levels of government over the past five years.

Percent Expressing Confidence In Government

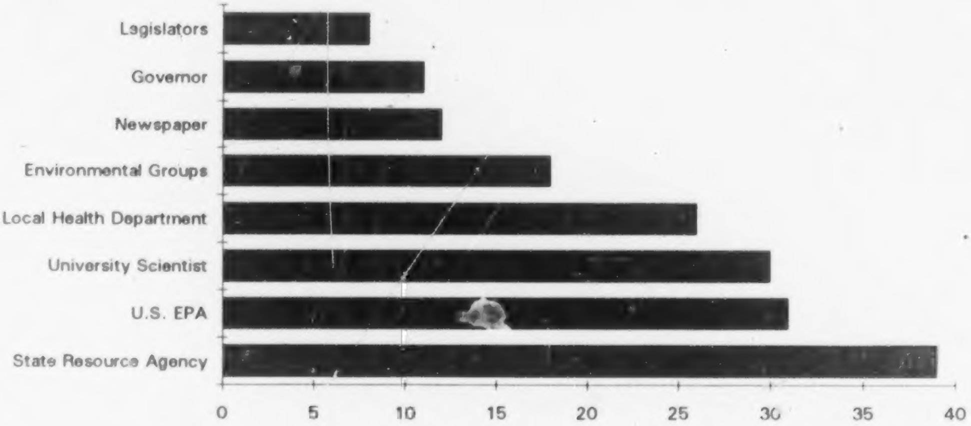


The chart shows a dramatic decline in the percentage of respondents expressing either "a great deal" or "a fair amount" of trust and confidence in each level of government "to do a good job in carrying out its responsibilities." It also shows that confidence in local government is higher than in state government, but confidence in state government exceeds confidence in the federal government.

State officials can gain some consolation from the same survey's result when respondents are forced into a choice with the question "From which level of government do you feel you get the least for your money -- federal, state, or local?" In the 1992 poll, 49% of respondents selected federal, up from 36% when the question was asked in 1989. State governments fared best with only 16% selecting it as providing taxpayers least for their money, down from 25% in 1989. Local government was picked by 18%, also down from 25% three years ago.

A recent Michigan poll shows low confidence in elected officials. Respondents were given a choice of indicating a "great deal" of trust, some trust, or even less trust in sources of information about a hypothetical hazardous waste site near their homes. The chart shows the percentages indicating a great deal of trust in the information sources shown.

Percentage With Great Deal Of Trust In Each Information Source



Frustrations On Major Policy Fronts

The enthusiasm of the late 1980s is gone. The governors are now talking about underestimating the barriers in education reform. Many of the innovations of the 1980s — merit pay and career ladders, state-mandated comparisons of teachers, schools, and school districts, and more — are being dropped or reduced in the face of fiscal constraints and opposition from professional educators. University officials have stopped talking about new quality initiatives and increasingly talk of restricting enrollments and eliminating programs.

Welfare reform measures may have kept welfare rolls from being larger than they would have been, but this abstract victory is obscured by welfare rolls larger than they were. Health care for the indigent costs more, but leaves more indigents without coverage. Adult corrections has literally become a holding action, with little talk of rehabilitating prisoners. Less heralded state services, such as institutional mental health and parks, reflect attempts to maintain the status quo, not new activities.

With exceptions, cutbacks have not provided the major redirection of state policy sought by those who wish to restrict the role of government. Higher education changes exacerbate complaints like large classes, closed courses, and too much time to graduate, rather than providing a new emphasis on teaching. Vouchers and privatization have made little headway. Few states have closed major mental health and retardation institutions.

Summing It Up

In August, the National Governors' Association issued its agenda for the next year. One of the priorities is "redesigning state government," to which the governors hope to contribute with a task force on state management. The announcement of the agenda included this description of how things are going:

> *Unfortunately, Americans are increasingly skeptical about government. The public is frustrated by a lack of responsiveness and accountability, by waste and inefficiency. The result of this frustration is lower voter turnout, citizen-initiated tax and spending limits, and an unwillingness to support new public programs.*
>
> *Citizens used to think that government action could solve many domestic problems. Today many Americans see government itself as the problem.*
>
> *Clearly there are problems in government. We have sometimes oversold new government initiatives. Many program results have fallen short of their promise. Federal mandates have reduced state flexibility and undercut decision-making. In turn, sate mandates have hampered local flexibility and decision making. As programs grow, they become more rigid. Decisions are made by faceless bureaucrats, and as programs are centralized, accountability becomes ever less clear. Everyone takes credit and no one takes responsibility.*
>
> *Our challenge is clear. We must recognize that public skepticism is sometimes justified, that government is not the appropriate tool for every task, and that even well-run programs must change to meet new problems and new challenges.*

Things Are Likely To Get Worse Before Getting Better

The major difference between state policies in the early 1990s and in the last serious recession in the early 1980s is the outlook for recovery. The sharp tax increases of late 1982 and 1983 were followed by a period of rapid economic recovery and swelling state revenues. They permitted program expansions and substantial tax cuts in 1985 and 1986. This year, the combination of reluctance to adopt hard choices between sharp spending cuts and/or tax increases and the slow economic recovery mean that many 1992 problems are simply being carried into 1993.

California is the outstanding example. Elementary and secondary education spending of nearly a billion dollars is being advertised as a loan to the schools, giving next year's legislators the choice of continuing from the base of this year's outlays or using the outlays minus the loan component as the new starting point. Several billions of the California problem was "solved" by one-time measures, so it will have to be solved again next year. Several billions of the California problem wasn't solved at all, just carried forward with funding from revenue growth that seems unlikely to be realized.

The Medicaid Time Bomb

This year's state finances are in much better shape than they could have been. The states were immensely successful in expanding total and federal spending for Medicaid while avoiding double-digit increases in state general fund outlays or the appearance of new taxes. Many state fiscal officials, legislators, and health care executives remain extremely uncomfortable with the devices by which this has been done. No wonder. They rely on two mechanisms which appear untenable as national policy.

The first is paying for health care by taxing health care. The new provider taxes cannot cut the costs of health care to consumers or employers. They have financed higher provider reimbursement rates than would otherwise exist and reduced the pressures for Medicaid cost controls. By increasing the costs of employer-provided plans and self-pay, they have fueled the already substantial pressures for cutbacks in private plan coverage.

The second is forcing federal outlay increases of over 20% per year for Medicaid. No serious plan for cutting the federal deficit ignores this. The implication is: (1) serious efforts at federal budget-balancing aren't in the cards, or (2) the pattern of Medicaid financing will soon be threatened. Either way, state officials don't like the outlook.

REFORMING THE STATE BUDGET PROCESS

> *The people believe it is time to take our destiny in our own hands. In order to restore accountability to our government, we ... find it is necessary to reform the budget process.*

These words from the budget reform amendment package in California could be heard in most states.

The Case Against The Budget Process

Something must be wrong with state budget processes. Opinion polls consistently show that the public believes that states waste money. Voters and many legislators believe that state taxes are too high while spending on what they view as vital services is being neglected. The processes are designed to produce balanced budgets. But spending often deviates considerably from the plan. Agencies administering welfare and Medicaid routinely spend at rates that will exhaust their appropriations by spring — confidently expecting that legislatures will appropriate more rather than halt programs until the new fiscal year. The resulting budgets often aren't balanced.

Besides being unhappy with the results of their state budget process, many are unhappy with the process itself. It starts with a governor's budget that is often immediately denounced as "dead on arrival" or unrealistic. In many states, it continues with mark-up of appropriations bills, which cannot be related to overall fiscal decisions like whether to change tax levels because those decisions haven't yet been made. The process typically nears its end with secretive meetings followed by late-night votes on complex bills that legislators couldn't have read.

After it's over, legislators and the media discover mistakes and provisions that are, at a minimum, embarrassing. Legislators and outside critics condemn the absence of an overall state plan or strategy and the ad hoc nature of the budget's many compromises. They resolve to do better the next time, with many proposals offered to make that happen.

Some states don't get their work done on time, producing at least a sense of guilt and at most closed state offices and missed payrolls. Fears of voter reaction against incumbents helped keep the number of late budgets down in 1992, but California's late action drew national publicity to the problem. Congress does even worse -- sometimes using temporary appropriations for an entire fiscal year, clearly not solving a massive deficit problem, constantly resetting targets so the targets have little or no effect on current decisions, and periodically enacting new budget reforms to replace the last ones after their failure is incontestable.

State officials correctly complain that the federal process counts dollars flowing through the federal treasury as dear but doesn't count dollars extracted from state and local taxpayers through mandates. Local officials, also with considerable justification, make a similar complaint about the states.

Budget Reform Proposals

Nearly everyone agrees that something about state and federal budgets could be better. So nearly every candidate for state and federal office endorses budget reform. Often reform in budget processes is offered as a substitute for hard choices about tax levels, spending patterns, and priorities. A room could be filled with analyses and studies of proposed reforms.

The standard list of budget process reforms includes choices made differently among the states: whether to: (1) use annual or biennial budgets, (2) consider program or line-item budgets, (3) use a zero-base or some other base, (4) begin the fiscal year in July or some other month, (5) leave two months or seven months between executive submission and scheduled enactment, (6) make appropriations in a single bill or many bills, (7) give the governor line item and amendatory veto power, and (8) prohibit or include substantive language in appropriations bills.

Individual observers have preferences for making these choices and arguments for why they like their choices. However, there is little empirical evidence suggesting that one choice is better than another. As a result, much of the budget process reform discussion involves changes with no national pattern, such as moving from annual to biennial budgets in some states and from biennial to annual ones in others.

Spending Limits And Stimulants

Some of the reforms, such as annual rather than biennial budgets and consensus revenue estimating procedures, would appear to be neutral in their effects on the growth of spending and taxes. Other reforms are designed to curb the growth of state-spending. Some of these seem to work. Examples are:

(1) limiting revenue used as a basis for the budget to a number below most likely revenue (e.g., **South Carolina**), such as the revenue realized in the last completed year or a percentage point or two below expected revenue,

(2) making some or all spending contingent (e.g., **Arkansas**) on revenues,

(3) automatically implementing pro-rata reductions in spending when the budget appears out of balance or imposing a *duty* on governors to cut spending to conform to revenues, as was recently used in **Ohio**,

(4) putting constitutional limits on revenue such as indexing for inflation, requiring popular votes to raise revenue (e.g., **Missouri** and **Oklahoma**), and prohibiting certain taxes (e.g. **Florida**),

(5) prohibiting state and local spending, with criminal as well as civil penalties, at rates designed to exhaust appropriations before year-end, and

(6) placing constitutional ceilings on state spending/or taxes like **California**'s Gann Amendment and **Missouri**'s Hancock Amendment.

The effects of other attempts to limit spending growth are more ambiguous. The **California** budget impasse provides an example. California requires extraordinary majorities (2/3 in each House) to adopt a budget, as do **Arkansas** and **Nebraska**. Proponents assume that the result will require high-spending majorities to defer to opinions of low-spending minorities, but the reverse could also prove true. This year, the provision probably restrained spending in California, but could well have worked in reverse in **Florida**. There a bare majority in the Senate was opposed to the major increases in taxes being pushed by the governor. That body could muster enough votes to obtain a majority for the austere alternatives it passed, but probably would have had to made concessions to higher spending to obtain a 2/3 vote.

Some budget reforms are cost-increasing, although their proponents don't typically argue for them on this basis. The argument for them is that "reform" is needed to ensure adequate spending for favored functions. The education spending mandates of **California**'s Proposition 98 and the new **Louisiana** requirement for funding the school aid formula off the top are examples. Many states have adopted multi-year funding programs for school aid and permanent appropriations and/or automatic cost-of-living provisions in some of their programs. Some, but not all, earmarking of revenue has been cost-increasing for overall state budgets. Two clear examples are the earmarking of education money in **Alabama** and devoting **Oklahoma** sales tax revenues to welfare, which was later repealed.

Current Budget Reform Examples

In November, voters in **California** will accept or reject a voter-initiated constitutional amendment being pushed by Governor Wilson. The multiplicity of provisions indicate the many subjects that can be called budget reform. One part provides the governor with power to cut the budget after enactment, if he finds such action is necessary to assure a balanced budget. Such power, including power to cut school aid and other payments exempted by the California amendment, is already in the hands of some governors. Another provision cuts welfare payments in several ways, including an immediate 10% reduction. Another bars legislators and the governor from being paid if the legislature fails to enact a budget by the June 15 deadline. A unique provision would allow the governor to write his own budget, without legislative approval, to deal with a fiscal emergency that would arise if the legislature failed to act on the budget.

In **Florida**, a unique tax and budget reform commission has the authority to put fiscal measures on the ballot without legislative approval. Several such measures are on the November ballot, including budget reform, a taxpayer bill of rights, and local option taxes. The budget reform measures are oriented toward a more open process (e.g., a 72-hour period between introduction of budget proposals and their enactment) and closer ties among budgeting, program assessments, and planning.

At the NCSL Annual Meeting in August, there were several panels which discussed aspects of budget reform. In **Colorado**, the stress is on auditing, linking audit results to the budget process, putting performance measurements in budgets, and a financial reporting system. In **Texas**, where the move to performance measurement in the budget process started twenty years ago, the emphasis is now on special efforts by the comptroller to identify savings and on a statewide strategic planning process linked to the budget process. It draws on earlier experiences of **Florida**, **Louisiana**, and **Oregon**.

Of the presentations at the meeting, **Iowa**'s exhibited the most complete combination of substantive and process changes.

Iowa's problem was perceived as a structural deficit driven in part by built-in increases. In FY 1993, these created a budget gap of $210 million despite a projected revenue increase of 6%. In addition to the usual problems, such as Medicaid, Iowa had substantial built-in increases in its funding formulas for community colleges and public schools, an adverse court decision on state employee salary increases, and several losses in the courts on state taxes of pension income and income of corporate foreign subsidiaries. The solution was to modify formulas, eliminate "standing unlimited appropriations" in favor of annual appropriations, cap certain entitlements, limit certain Medicaid spending and study more limits, ceiling appropriations to 99% of available revenue estimated through a consensus procedure, and establish a new reserve fund.

The Iowa legislature passed legislation requiring five-year plans, implementing periodic program reviews somewhat similar to "sunset" reviews in other states, and requiring the governor to submit a biennial budget. The governor vetoed the legislation because of differences over how the periodic program reviews would work and because he wanted a mandate that the legislature adopt a biennial budget, not just have him submit one. The state also has pilot projects using new budget procedures — zero based budgeting in the natural resource agency and program performance measures in the health agency.

Fighting For Control Over Enacted Budgets

The need to cut back spending from appropriated levels in order to maintain budget balance has produced many executive-legislative disputes over the past several years. A new NCSL report concludes that the dispute over executive and legislative roles is "long-standing," but "it has been enflamed during the past two years because of serious state fiscal problems."

The 93-page study includes survey information from 41 states and analysis of the issues associated with legislative oversight of budget administration as well as allocation of authority for adjusting previously enacted budgets. It also covers recent litigation on the subject in **Alabama**, **Florida**, **Michigan**, and **Wisconsin**. Presentations at the NCSL meeting provided case studies of disputes on executive and legislative roles in **Hawaii** and **Michigan**.

Legislators often have mixed feelings about control over enacted budgets. They recognize that giving governors the unilateral power to change appropriations reduces their authority. But they also recognize the desirability of giving governors and agencies management flexibility and the political hazards of mid-year budget cuts made by legislative rather than administrative action. The study concludes, "Legislators generally are dissatisfied with their level of control over enacted budgets but have been slow to make reforms."

FINANCING AND REFORMING SCHOOLS

Introduction

California's debate over financing schools provided a good example of the national pattern in the FY 1993 state budgets. Unlike other states, **California** has put educators' minimum fiscal aspirations into its constitution: (1) maintaining education's percentage share of the state budget, or, if more, (2) adjusting base year spending by amounts necessary to cover (a) enrollment changes and (b) inflation. But in a no-new-tax environment, the state couldn't meet these standards.

Much of the final delay in enacting a budget involved how to package what was done in relation to these standards. They used exotic concepts such as making part of the FY 1993 school aid a loan against future entitlements under this Proposition 98 formula. One characterization of the California result is maintaining per pupil state aid, adjusting for sharp enrollment growth but not inflation.

Nationwide, the 5.5% increase shown in NCSL's preliminary fiscal survey was enough to cover inflation (3% nationally) and enrollment growth (about 1%). It was not enough to make major progress on agendas for education reform or to adopt new school equalization plans while preventing more affluent districts from receiving less aid than in FY 1992. Excluding states that raised taxes, education money nationwide probably didn't cover current services, that is, adjusting for enrollment and inflation. With property values dropping in a few states and stagnant in many, local money couldn't make up the difference in most states. As a result, education quality and equalization plans are often on hold.

Education Money

While state elected officials again this year sought to raise K-12 education spending more than other programs, it appears that this was unattainable for most states without tax increases. The 5.5% increase reported by NCSL combines large increases in states that raised taxes for education (e.g., **Colorado**, **Kansas**, **Maryland**, **Mississippi**, **Tennessee**) coupled with nominal increases in many other states and cuts in 5-10 states. In **Pennsylvania**, legislators had to decide whether to let the temporary increase in the flat rate income tax expire (which they did) or increase K-12 spending (which they didn't, despite last year's promise of $125 million in new FY 1993 money).

Massachusetts legislators and the governor more or less agreed on about $186 million in new FY 1993 education money, but the deal broke down when the legislature didn't enact the reforms the governor sought.

The governor vetoed the appropriation, but the legislature overrode the veto with the suggestion that the reforms would be addressed in the fall. Unlike the pattern of independent school districts in most of the country, Massachusetts schools are run by school committees under some control by municipalities. Arguing that priorities are unbalanced when police are laid off while schools expand spending, Boston's Mayor Flynn (with support from the association representing Massachusetts cities and towns) has attempted to capture some of the new school money for city operations.

Status Of Reforms

Much of the bloom has disappeared from the education reform rose. This is not only due to state fiscal problems but also increasing recognition of obstacles to rapid change in public education. The problems are indicated by the title of the summary report released by the nation's governors at their annual meeting in August. They called the report, *Redefining The Possible*, and included a subtitle in their press release, *Governors identify barriers and opportunity for change*. The reports on education quality released at the meeting have a different tone from those of the 1980s, which seemed to envision rapid reform as a result of widespread adoption of governors' initiatives.

Governor Ashcroft, leaving office as NGA's chairman, talked of states "grappling with strategies" and commented, "Clearly systemic change is difficult, but it can be done." There was much discussion of a "decade-long commitment." The new NGA chairman, Governor Romer, commented in his agenda for the new year:

> *Standards are meaningless unless all of our citizens — students, parents, educators, employers, and policymakers — understand and support them, and unless they feel personally accountable for achieving them.*

The linkage between funding and standards for reform is suggested by **New Hampshire**. In August, the state school board, on a divided vote, eliminated the state's minimum standards in areas such as limits on class sizes, mandated programs for gifted students, and training requirements for guidance counselors. The state superintendent opposed the move as did several board members, one of whom resigned over how it was handled. Some observers fear that the state constitutional prohibition against new unfunded mandates on local government will prevent the state from ever again imposing standards. Of 162 districts in the state, over 60 have eliminated kindergarten. New Hampshire opted to deal with its financial problems by eliminating most of its previously lowest-in-the-nation state support of public schools.

Many states have been shifting their education departments from a mandating and policing role to a technical assistance role. In **Georgia**, the change is called eliminating a "gotcha" mentality by moving to an attitude of helpfulness.

SCHOOL FINANCE LITIGATION

Equalization Cases Continue

There are about 23 states with school finance litigation pending. The threat of cases is influencing policy in many states where no cases are currently in the courts.

The U.S. Supreme Court decided long ago that the U.S. Constitution doesn't require funding equity, so the current cases rely on state constitutional language. State courts continue to split on the issue of whether state constitutions require equalization. Litigation was rejected in cases in the late 1980s in **Louisiana**, **South Carolina,** and several other states. Plaintiffs won in 1989 through 1991 and have forced major school aid formula revisions (and higher total state outlays) in **Kentucky**, **Montana, New Jersey**, **Tennessee**, and **Texas**.

In many of the states, plaintiffs aren't diligently pressing their suits. Instead, they are using pending litigation as one mechanism to force legislative action. At the same time, they fear the possibility that final court resolution might be adverse to their cause and reduce pressures for legislative action. In some states, defendants aren't pressing their case hard either. The best example is **Alabama**, where the state's case is stronger than most because there is no language on public schools in the state constitution. The governor and other elected state officials have tried to get out of being defendants and join the plaintiffs. The arguments in trial court are more over how much the court should order the state to spend than over whether the school formula violates the state constitution.

Developments In Four States

Using a lawsuit as a pressure device worked in **Kansas**. Last year, the judge didn't bring the case to trial, but did issue a memo on the principles of constitutional school finance. The legislature revised the school aid formula this year — increasing equalization, total school funding, and state taxes in the process. In May, the judge dismissed the pending action, though some disappointed districts are talking about starting new litigation.

In August, the **New Hampshire** equalization suit lost at the trial court level. The decision will be appealed. The court found that the state's constitutional requirement deals with a duty to "cherish ... public schools," not tantamount to a requirement of equity or adequacy of education. The Granite State, which has massive disparities in tax base per pupil among its many small districts and the lowest percentage of school costs paid by state aid of any state, has some of the least equalized school finance arrangements in the nation. In the last several years, it eliminated its small equalization program as an austerity measure, except to the extent that state-funded equalization is covered by lottery proceeds.

The most significant of the unresolved school finance issues is in **Texas** where the state supreme court has insisted on equalization and the legislature has responded with more money and a succession of equalization plans. The latest was rejected by the court on non-equalization grounds. The use of county education districts with county-wide tax bases was found to violate a prohibition in the constitution against statewide property taxes. The state court made its invalidation of the tax prospective, to take effect next summer. A federal court declined to overturn this unusual approach of permitting collection of an admittedly unconstitutional tax. It decided that no substantial federal question was presented.

The governor talked earlier this year about a summer 1992 special session to resolve the issues. She dropped the idea after it became clear that no plan seem likely to get a majority in the legislature. A special session after the November elections is likely. Meanwhile, promised state aid is being prorated, so districts get only a percentage of the money the formula indicates they should receive. The problem was caused by underestimating both enrollments and local tax effort, both of which are elements of the Texas formula. The prorations were designed to save about $240 million in FY 1992 and more than $500 million in FY 1993.

This spring the governor announced a plan that would move the entire business property tax system to the state, eliminating most of the disparities among districts. The resulting revenue would be used to equalize funding under a first tier traditional foundation formula. It sets target spending based on the number of pupils, subtracts required local effort based on a statewide tax rate and the local property tax base, and requires the state to pay the rest. The second tier would provide an increment of funding whereby equal additional local tax effort would produce equal increments of revenue regardless of differing local tax bases, because the state would make up the difference for poor districts. The third tier would consist entirely of local effort.

The 1976 **California** decision in Serrano v. Priest is a landmark for plaintiffs in school finance litigation under state constitutional provisions. Since then, California (along with **New Mexico**) has been maintaining one of the most equalized school finance arrangements in the nation. This hasn't prevented further litigation by the Association of Low Wealth Schools. Tired of the process, the state itself has initiated litigation to get state courts to reaffirm the Serrano case and put an end to further litigation and discussion.

Measuring Disparities In Funding

There are many different ways to assess funding disparities. The simplest is to compare per pupil spending, with no adjustments for differences in local tax effort or cost-driving factors, such as disadvantaged students or substantial transportation requirements, that might cause differences in spending.

Comparing the highest spending district to the lowest shows the maximum disparity, even when the comparison excludes districts with less than 50 students. This comparison is shown for some representative states in the table.

Highest And Lowest Per Pupil Spending Per Pupil

State	Highest	Lowest	Difference	Ratio
Florida	$5,489	$3,836	$1,653	1.4
Arkansas	5,843	2,081	3,762	2.8
Arizona	8,023	2,714	5,309	3.0
Pennsylvania	9,504	3,148	6,356	3.0
Massachusetts	8,634	2,817	5,817	3.1
Michigan	8,407	2,491	5,916	3.4
New Jersey	11,820	3,074	8,746	3.8
California*	11,740	2,692	9,048	4.4
New York*	19,238	3,127	16,111	6.2
Illinois	14,316	2,253	12,063	6.4
Texas*	14,514	2,150	12,364	6.8
United States	22,329	1,975	20,354	11.3

* FY 1991 data, other states show FY 1990.

New Issues In The Cases

Some of the recent suits raise issues beyond the traditional one of providing roughly equal spending among districts within a state with roughly equal local tax rates. The new issues involve: (1) capital facilities as well as operating costs, (2) claimed special needs such as those of disadvantaged pupils in urban areas, and (3) the question of whether state aid is adequate, as distinct from whether it is equitably distributed. Adequacy cases are now active in **Alabama**, **Connecticut**, and **Louisiana**. Given favorable rulings in any of these cases, they could quickly become a nationwide phenomenon.

Desegregation Litigation

Spurred by successes of the Kansas City, Little Rock, and St. Louis school districts in getting a special pipeline to state money, school districts in other states are litigating to remedy past segregation. There is a case in federal court in **Georgia**, for example. **Missouri** is spending nearly 10% of its general fund budget on St. Louis and Kansas City remedies. It is continuing to contest the spending mandates, which give these urban districts considerably more state aid than other areas of the state.

A **Connecticut** case attempts to deal with predominately minority Hartford schools and predominately white schools in the Hartford suburbs by relying on both the education and the equal protection clauses of the state's constitution.

Many school districts remain under varying degrees of federal control resulting from a long line of desegregation cases. The March U.S. Supreme Court decision in Freeman v. Pitts, involving an Atlanta area school district, was generally viewed as facilitating reduction of federal supervision in these cases. In that divided opinion, the court's majority found that, "Racial balance is not to be achieved for its own sake." Instead, "Once the racial imbalance due to the *de jure* violation has been remedied, the school district is under no duty to remedy imbalance that is caused by demographic factors."

The case involves the De Kalb County schools, which shifted from only 5% minority enrollment in 1969 to about 50% in 1986, and two-thirds currently. State funding is generally not directly involved in these cases, but many states have responded indirectly to the special costs of districts affected by past desegregation orders.

ENROLLMENT AND POPULATION ESTIMATES

Introduction

With many people worried about structural budget imbalance, demographics has become an important subject. School enrollment changes are driving part of the budget problem in **California** and are responsible for school aid cuts in **Texas**. The Census Bureau decided to ignore possible undercounting of population for purposes of reapportionment, but must reconsider the issue in determining federal aid to state and local governments.

Population Counts

The enumerated count of population from the 1990 Census was 248.7 million, but Census Bureau experts estimated that the actual U.S. population was 254.0 million, an *undercount* of over five million. The methods used to estimate the undercount were national ones, so the Census Bureau is unsure of how it might be allocated among states and even less confident about how it might be allocated among Congressional districts, counties, and cities. For this and other reasons, the Bureau decided not to use the undercount for its estimate of 1990 population used for both federal aid and reapportionment.

Now the Census Bureau faces the problem of what estimates to use between Census years (1990 and 2000) for many important purposes including the annual estimates of state population and the local estimates made every other year.

To complicate its problem, the Bureau has decided its original estimate of undercount was inaccurate due to "a significant computer processing error" and further research. It now estimates the 1990 population, which is the starting point for 1991 and subsequent year estimates, was 252.7 million. Options for adjustment of the 1990 baseline range from making none to adjusting the estimates for every jurisdiction in the U.S.

The new undercount estimate would, if used, adjust population upwards substantially in **Texas** (2.8%), **California** (2.7%), **Arizona** (2.4%), **Georgia** (2.1%), and smaller, mostly Sunbelt, states. Lesser adjustments would be made in most Northeastern and Midwestern states. Making the adjustments would shift money (relative to allocations with no adjustment) to the states with the largest undercounts. Because the formula used for AFDC and Medicaid is based on a state's per capita income relative to national per capita income, adjustments would also increase the federal cost sharing percentage for some states with large undercounts. The more affluent of those states wouldn't be affected because they would get the minimum 50% federal share under either population count.

Predicting School Enrollment

> *Some of the projections strain credulity. In other words, they appear seriously flawed.* -- Steven Gold, April 1992

Most states got a big break from fiscal pressures in the 1980s because their public school enrollments didn't grow, while the number of workers contributing tax revenues grew substantially. The situation will be less favorable in the 1990s, but there is disagreement about how much enrollment is likely to increase. One doesn't need to look beyond the presumptive oracle on the subject, the U.S. Department of Education, to find the disagreement. In 1990, DOE's National Center for Educational Statistics (NCES) advised that public school enrollments would grow by 7% over the 1990s. In 1991, DOE advised they would rise 13%, inspiring the comment quoted at the beginning of this article.

Growth of 7% is a comfortable rate of national change for state finances, well below the growth of taxpayers in the same period. The 13% rate is less comfortable, but not as serious as pressures likely to come from Medicaid costs, federal mandates, and increases in inmates and child welfare cases. Nationally, the major difference between the two numbers is the shift by NCES from Census Bureau "medium" to "high" population projections. The difference relates to assumptions about in-migration to the United States and birth rates. The high projections imply higher state costs, without corresponding revenue, for AFDC, Medicaid, and programs to serve children, as well as for education.

On a state-by-state basis, it is reasonable to try to relate the NCES numbers to three anchors: (1) recent enrollment changes in the state, (2) local projections of future enrollment, anchored by the fact that practically all children to be enrolled in the 1990s are already born and most are in school, and (3) recent demographic trends in the state. The table below is designed as a checklist. It compares the NCES projection converted to an annual increase with the increase in school age population from 1990 to 1991, also converted to an annual increase.

Two Views Of Possible Enrollment Growth In the 1990s

Rank	State	Census	NCES	Rank	State	Census	NCES	Rank	State	Census	NCES
1	Nevada	6.3%	0.1%	18	Missouri	1.5%	1.2%	32	Pennsylvania	0.7%	1.1%
2	Alaska	4.1	3.0	18	Nebraska	1.5	-0.8	35	S. Carolina	0.6	1.0
3	Washington	3.5	-0.4	20	Georgia	1.4	2.1	36	Illinois	0.6	2.1
4	Idaho	3.0	-0.4	20	Vermont	1.4	1.8	36	Maine	0.6	2.3
5	Florida	2.9	2.5	22	South Dakota	1.4	1.0	36	Michigan	0.6	1.0
6	Oregon	2.8	-0.2		**United States**	**1.4**	**1.3**	36	N. Hampshire	0.6	3.3
7	California	2.6	1.8	23	Virginia	1.3	4.0	40	Ohio	0.5	0.0
8	Colorado	2.4	0.8	24	Hawaii	1.1	4.7	41	Louisiana	0.3	1.4
9	Minnesota	2.2	-0.2	24	Iowa	1.1	-1.0	42	Indiana	0.2	0.1
10	Maryland	2.1	3.1	26	Montana	1.0	-0.5	42	Massachusetts	0.2	1.7
10	New Mexico	2.1	3.5	27	Connecticut	1.0	1.6	44	Alabama	0.2	0.7
10	Utah	2.1	1.1	28	Wyoming	0.9	-0.8	44	Arkansas	0.2	0.5
13	Wisconsin	1.9	-0.6	29	North Carolina	0.8	2.9	44	Tennessee	0.2	1.2
14	Delaware	1.8	2.0	29	Oklahoma	0.8	-1.4	47	Kentucky	0.0	-0.1
15	Texas	1.8	-0.1	29	Rhode Island	0.8	1.3	48	North Dakota	-0.1	-0.8
16	Kansas	1.7	0.2	32	New Jersey	0.7	3.9	49	Mississippi	-0.2	1.2
17	Arizona	1.6	1.6	32	New York	0.7	1.9	50	West Virginia	-1.4	-0.7

Even the most casual scrutiny of the table shows that there are incredible disparities for some states. The disparities are most severe for states with uneven economic performance over the past decade. For example, the population counts reflect the recent prosperity of the Northwest. The historical method used by NCES has these states mired in mid-1980s economic problems. Conversely, New England states get credit in the NCES projections for late 1980s prosperity while the Census counts reflect the downturn of the 1990s.

Skepticism May Be Warranted

The lesson from the table and from the last decade of population projections from all national sources, private and public, is that national projections are not to be trusted.

Population in general, and school enrollment in particular, respond to the economic circumstances of the time. Many factors affecting those circumstances — war and defense spending, oil prices, the competitiveness of U.S. manufacturing — are not easily predicted.

Individual states have an advantage, which not all of them use, of being able to make their fiscal and other projections (e.g., those used to plan transportation and higher education investments) consistent. That is, projections of prosperity would affect state revenues and employment as well as enrollment. That way overestimates and underestimates will tend to cause consistent adjustments in both revenue and spending.

This safeguard in the state estimates works only if the demographic projections used for spending estimates are consistent with the economic and demographic projections used for revenue estimates. This linkage is made consistently and in considerable detail in some states, such as **Florida**, but not in all states.

MISCELLANY

Deficits

NGA's new chairman, Governor Romer (CO), called reducing the federal deficit the "number one priority" for the group's executive committee. He warned the deficit has increased interest rates, reduced capital investment, and slowed economic growth. He said:

> *We must build the political will in our states and in the nation that is needed to make some tough choices. Inaction is in itself a choice — and it is a disastrous choice.*

The federal and state news on the deficit front hasn't been good. The Congressional Budget Office August update projects a total federal deficit of $331 billion (5.3% of gross domestic product) in FY 1993. Unlike many past projections, automatic improvement isn't in the long-term forecast. CBO sees the deficit, without policy change, dropping to $254 billion in FY 1996, but rising to $290 billion in FY 1997. OMB is somewhat more optimistic about the long-term outlook, but more pessimistic in the short term.

The estimates imply bad news for states in the Medicaid program. CBO suggests 13% annual increases in the mid-1990s. OMB suggests even faster growth. One concern of the governors is the often-proposed cap on federal spending increases for Medicaid and AFDC. Romer urges that any cap control state and federal costs, "rather than reducing the federal share and shifting the costs to states."

Driven by Medicaid, federal aid to state and local governments is continuing to grow much more rapidly than other income. In the second quarter if CY 1992, preliminary Department of Commerce estimates show grant growth of 12% versus growth in state and local income taxes of 5.6%, in sales taxes of 6.9%, and in property taxes of 7.1%.

Excluding surpluses at all levels of government in social insurance funds like Social Security and employee retirement, the second quarter CY 1992 deficits (seasonally adjusted at annual rates) were $44 billion for state and local governments and $331 billion for the federal government. With the insurance funds, the state and local sector had a surplus of $14 billion, but the federal government had a deficit of just over $300 billion.

Getting Beat Up In The Courts

There is no recent single issue or dramatic court decision to illustrate how state policy decisions are faring in the courts. However, the sheer volume of litigation over the past year has been significant. Examples: (1) the school formula litigation discussed in this issue, (2) litigation on the fairness of distribution of state funds for higher education, (3) litigation over state budget-cutting measures, particularly the efforts to limit state general assistance spending, (4) cases involving state taxing power including ability to tax mail order sales and foreign earnings of corporations and to apply differential tax provisions to in-state and out-of-state firms, (5) threatened litigation on Medicaid reimbursement rates, and (6) mandates of spending despite the absence of appropriations.

The states aren't losing all these cases. They have won some key ones, such as judicial approval of California's Proposition 13 effects on property taxes. The legal environment for avoiding court supervision of state corrections and mental health institutions is better than several years ago. States and local governments are generally winning cases seeking to avoid liability based upon exercises of discretion (e.g., not taking a child away from natural parents, allowing parole) that don't work out well.

However, the volume of litigation is having an impact. As the school finance cases illustrate, the cases are expensive to litigate and can result in expensive action to avoid final court decisions. Even when states prevail on appeal, lower court decisions, particularly injunctions, can significantly affect state policy at key times. An example was the court-ordered distribution of Medicaid funds while California lacked a new budget.

Health Care Provider Reimbursements

The conventional wisdom is that state reimbursement rates for health care providers are significantly below their customary charges. State-by-state comparisons of private and Medicaid rates are difficult for many reasons, such as differences in services provided and populations served and incomplete reporting of private charges.

When such comparisons appear, they often raise more questions than they answer. The table provides a recent example. It comes from new data (available only for the 33 states shown) on nursing home daily rates paid by Medicaid and private patients.

Ratio Of Private To Medicaid Nursing Home Rates, 1989

Rank	State	Ratio	Rank	State	Ratio	Rank	State	Ratio
1	Rhode Island	0.41	12	Texas	1.10	23	Wisconsin	1.25
2	New York	0.51	13	Louisiana	1.11	24	New Mexico	1.26
3	Minnesota	0.86	14	Colorado	1.13	25	Missouri	1.46
4	Kentucky	0.88	15	Wyoming	1.13	26	Vermont	1.50
5	Michigan	0.93	16	Montana	1.14	27	Alabama	1.56
6	Tennessee	0.97	17	Florida	1.16	28	Maine	1.58
7	Oregon	0.99	18	Idaho	1.19	29	New Jersey	1.61
8	Ohio	1.06	19	Virginia	1.20	30	Connecticut	1.68
9	Delaware	1.08	20	Illinois	1.23	31	Georgia	1.82
10	North Carolina	1.09	21	California	1.25	32	Utah	1.96
11	South Carolina	1.10	22	Massachusetts	1.25	33	Nevada	2.04

If states pay somewhat less than private patients, the ratios would be in a range of just over one to one. Allowing for problems in the data, the range from 0.9 to 1.26 is probably in the ballpark. The other results beg investigation. Four states are apparently paying much more for Medicaid than private patients pay, twice as much in **New York** and **Rhode Island**. Conversely, eight of the states shown have Medicaid rates a third or more below private rates, including **Connecticut** which mandates that Medicaid nursing home services be identical to those provided private patients.

TECHNICAL NOTES

Awful Year: For a more detailed assessment of the California action and outlook, see Issue 17 of State Budget & Tax News. The public opinion poll cited is the annual one by the Advisory Commission on Intergovernmental Relations (800 K St., NW, Washington, DC 20575), Changing Public Attitudes On Government And Taxes 1992. The Michigan poll is from Public Opinion Monitor (August, published by Public Sector Consultants, 308 S. Washington Sq., Lansing, MI 48933).

Budget Reform: There is little empirical evidence on the impact of budget reforms. First, there isn't complete agreement on what successful reform means — slower spending growth? adoption of budgets well before the beginning of the fiscal year? or someone's view of more rational allocations among programs?

Second, while it is easy to study the correlation between features of a budgeting system, such as use of annual or biennial budgets or presence or absence of line item veto, and fiscal outcomes, such as spending growth rates, so many other factors affect the outcome that it is nearly impossible to associate the outcome with the budget process variable. For a more detailed discussion of reforms, see Vol. 8, Issue 18 (Sept. 1990).

Cassette tapes of the budget reform and other major sessions at the NCSL meeting can be ordered from First Tape, Inc., 770 N. LaSalle St., Chicago, IL 60610. The new NCSL report by Corina Eckl is Legislative Authority Over The Enacted Budget. It replaces the NCSL report (A Legislator's Guide To Budget Oversight After The Appropriations Act Has Passed) that has been the reference work on this subject since its publication in 1983.

Financing Public Schools: For a good summary of the school finance issue, see The State Of Inequality (Educational Testing Service, Princeton, NJ 08541, 1991). The report contains a table contrasting spending levels of the top and bottom spending ten districts in each state. It shows somewhat less disparity than the table contrasting the spending per pupil of the top and bottom districts, which was developed from a 50-state table appearing in Education Week (6/17). Because of special provisions for transportation, school construction, separate categorical programs for certain special students, hold harmless provisions, and other factors, state school aid formulas are complicated. For an explanation of a typical one (which takes 24 pages), see Indiana Fiscal Policy Institute (251 North Illinois St., Indianapolis, IN 46204), A Guide To Indiana School Finance (1992).

Demographics: Gold's assessment, School Enrollment Will Rise In the 1990s, But How Much? was published in April by the Center for the Study of the States (411 State St., Albany, NY 12203) and by State Legislatures (July). The growth rates of population by age were released by the Census Bureau in an April 16 press release. The table comparing enrollment growth reflects the Census Bureau 1990-91 growth rate for the 15 months ending in July 1991 adjusted to an annual rate and the NCES rate as presented by Gold adjusted to an annual rate. The Census Bureau released its new undercount numbers in an August 5 press release. For a broader perspective on use of demographic forecasts in policymaking, see "Should Economists Be Dependent On Official Fertility Projections?" Challenge (July-August).

Medicaid Rates: The data on nursing home rates are from Jane Little's "Public-Private Cost Shifts In Nursing Home Care," New England Economic Review (July/August, 1992). Most of the article is a search for explanations of the large differences among states.

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SPR

VOLUME 10 ISSUE 18

IN THIS ISSUE

Many observers are looking at how California handled its budget crisis in order to predict actions in other states or prescribe how states should deal with deficits. There may be nothing to learn. California leaders produced different solutions in two successive years. The state's voters haven't yet spoken. And the fiscal problems aren't resolved.

- The Lessons Of California p. 2

California may just be another example of what state officials constantly discover anew — that better-than-average state economic performance can't last forever and that fiscal management is easier in a state outperforming the nation than one underperforming the nation.

- Fiscal Policy In Changing State Economies p. 5

Stagnation in the national economy equals stagnation in the states. In this context, the new Index of State Economic Momentum shows considerable convergence in individual state performance, with losers improving and former high-flyers sinking.

- State Economic Momentum p. 11

New comparisons of per capita income show convergence among states but appear to beg for adjustments to reflect differences in living costs and taxes.

- Comparing Per Capita Income And Living Costs p. 16

Miscellany covers counting population, counting tax increases, higher education, public opinion, university tuition prepayment plans, and what to do when states have no cash. Technical notes detail sources and caveats.

- Miscellany p. 20
- Technical Notes p. 23

STATE POLICY REPORTS

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September 1992 (Second Of Two September Issues)

THE LESSONS OF CALIFORNIA?

Introduction

As the dust settled over the September resolution of California's budget crisis, pundits immediately began to offer sweeping generalizations about what it all meant for state policies elsewhere, the mood of the taxpayer, and more. The state's action in rejecting higher taxes has been viewed as indicative of a pattern of resistance to tax increases. Its inability to deal with the issues in a timely basis and its program cuts, particularly in education, have been offered as showing a new pattern of austerity in the states.

California A Trend Setter?

In the occasional attempts to list "innovative" states or states whose policies are often followed later by other states, California is often mentioned. The evidence that California, or any other state, is a trend setter is mixed. For example, California policies on pollution control generally and auto emissions in particular now are playing a leading role in deliberations in other states. The "California standard" has been formally recognized as a goal by many Northeastern governors. However, California's Proposition 103 on insurance regulation was hailed as a trend setter when it was passed, but has only been followed (with major modifications) by a couple of states.

Concerned that "California's adoption of a Draconian budget last week is being seen as an augury for other states," fiscal expert Steven Gold concluded (in an OpEd for the New York Times, 9/8) that California hasn't been a trend setter. Evidence: (1) property-tax cutting Proposition 13 (1978) wasn't closely followed except in **Massachusetts** where property taxes were also high and officials were "arrogant" and "unresponsive," (2) the two-decade long period of avoiding tax increases wasn't matched by other states, and (3) last year's California tax increase, including raising taxes sharply for taxpayers with income more than $200,000, wasn't followed. So Gold argues that California simply demonstrates a more general problem in the states, "that states have more government than they can afford, given the current tax structure and way of providing services."

Gold notes that "California is not the first state to stonewall tax increases, citing **Illinois**, **Massachusetts**, and **Michigan** as other examples. But, he predicts, "Eventually, the balance will probably shift, and their citizens will decide that some increases are preferable to more service cuts." He suggests appropriate state policies include a mix of tax increases, spending cuts, and cost shifts, such as tuition increases.

SPR'S EDITORIAL OFFICE HAS MOVED. See new address and phone on p. 24.

California Problems Aren't Over

It may be premature to learn lessons from California's fiscal policies because the California returns aren't in yet.

Two Years, Two Solutions: With the same governor and legislators, California pursued two quite different fiscal policies in 1991 and 1992 when confronted with what was essentially the same issue, how to deal with an out-of-balance budget. In 1991, state officials took limited actions to control the growth of current service spending and increased taxes substantially. In 1992, they didn't increase taxes but took more decisive action to control current service spending.

Another Year, Another Solution: Neither of these actions, or both together, have solved the fundamental California fiscal problem, which will soon have to be revisited by state officials.

> *It's not a clean vote, but it is a vote that does something to solve the problem.* —Speaker Brown urging votes for the final budget.

Both the 1991 and 1992 actions included many temporary solutions that shifted fiscal problems to subsequent fiscal years. The early September borrowing of over $3 billion to cover operating costs is indicative of the magnitude of the problem that remains. Other actions, similar to some from other states, that shift costs to future years include:

Retirement plans have been tapped in various ways that will increase future costs through early retirement plans and restructuring of benefits.

Tax revenues from future years have been tapped by accelerating collections directly and indirectly by changing the ground rules for resolving disputes with taxpayers to lead to more and faster settlements.

Other funds have been used to supplement the general fund.

Reserves have essentially been eliminated. Summaries of the budget solution reported spending cuts from current service levels of $6.3 billion and revenue increases of $1.7 billion. These total $8 billion, leaving $2.7 billion of the acknowledged gap unaccounted for.

A Deficit in FY 1993 is probably built into the budget because the revenue estimates presume personal income growth that is unlikely to be realized.

As a result, California officials (including some new faces) will consider in 1993 the same issues that current officials dealt with differently in 1991 and 1992. How they will be handled in 1993 isn't obvious from past history.

Voters Have Yet To Speak

California's legislative elections and initiative process will provide a better opportunity for voters to speak on fiscal issues than is presented in most states.

> *We have not overcome the state's financial challenges, but with this budget there is a genuine attempt to move toward a balance of demands for government services and expected revenues.*— California Taxpayers' Association President Larry McCarthy on the new budget.

Anticipating that the legislature wouldn't go as far as he would like in reducing welfare payments and cracking down on spending, Governor Wilson and his allies have a measure on the November ballot that reflects their views. The measure is complex, including some provisions regarding executive and legislative power distribution with which many fiscal conservatives might not concur. It is also a ringing declaration of support for balancing budgets on a timely basis and controlling welfare spending. Voters who concur with the governor on these issues and believe that the Democratic legislative majority was the principal barrier to balanced budgets and appropriate spending restraint will presumably vote for this initiative and for Republicans in legislative elections.

Voters who believe that the state's budget cuts were excessive also can easily express their views. A "Fair Tax" initiative allows them to aim tax increases at corporations and at high income individuals, using part of the revenue raised to cut sales taxes and part to increase state spending. While Democratic legislators aren't campaigning as tax-increase advocates, voters have been subjected to months of news reports describing them as more favorable to taxes and spending than Republicans. So a backlash from spending cuts would be expected to find its way into a strong vote for Democratic legislators.

With these options for expression of voter sentiment and changes in the composition of the 1993 legislature resulting from the 1992 elections, it would seem premature to conclude that California's fiscal orientation is now clear.

It would also be premature to conclude that the elections will make the state's future fiscal orientation clear. There is no requirement that the voters' choices reflect a consistent perspective of lower taxes and spending cuts or higher taxes and fewer cuts. California voters, despite anti-incumbent sentiment, may decide as other voters have that their antipathy to the legislator doesn't apply to their own representatives and simply reelect incumbents. They may reject most of the initiatives, much as they did in the last election with a large number of initiatives on the ballot. They may reflect what the polls consistently show, that they favor lower taxes *and* higher spending. They could, for example, reject measures increasing taxes, reject the governor's measure, and adopt a health insurance mandate for private business that will also be on the November ballot.

FISCAL POLICY IN CHANGING STATE ECONOMIES

Poorly Performing Economy = Fiscal Problems
Old Situation, New State Affected

From a national perspective, much of California's fiscal problem is old news. Like other states, California felt the impact of recession. Unlike most other states, California also felt the impact of loss of economic momentum relative to the nation as a whole. This experience isn't new to the collective experience of state officials, or to the memory of long-time state officials in many states. But Californians have no such experience in their memories and little knowledge of states that have suffered this problem. It arises when a state's economy undergoes a period of nation-leading prosperity.

When The Good Times Roll

Extraordinary prosperity brings an immense demand for new facilities to accommodate the growing population — factories, new homes and neighbors, new public facilities, new restaurants and shopping centers, and more. The money to build these facilities comes, to a significant degree, from outside the economy.

> *California, one has to remember, profited from a generation and more of relentless economic growth. Millions of Americans from other states poured in with their savings, ready to invest. Then California became America's top defense and aerospace state, with vast billions of national taxpayers' wealth flooding into its factories. California could then spend freely without an onerous tax burden.* Neal Peirce column (9/20)

The prosperity feeds upon itself, bringing new citizens to exploit the job opportunities, new retailers and service workers to serve the expanding market, and new homebuilders and office developers to exploit the booming economy. Such an economy generates high levels of employment in business depending on the rapid growth — real estate agents, bankers, lawyers, construction workers, building materials suppliers and more.

The Costs of The Crisis

Observers will never agree on what the 1992 budget crisis cost. The delayed enactment clearly caused extra per diem payments to legislators staying in Sacramento, advertising and overtime associated with issuing "IOUs" to pay state bills, and the loss of savings in FY 1993 resulting from applying them to less than the full fiscal year. But other costs like interest payments from a lower bond rating and interest on the IOUs are more a result of the fiscal problem than from delay in dealing with it.

This prosperity brings wonderful news for state finances. The demographic results are outstanding. The prosperity brings an in-migration of new workers, wage earners and taxpayers who generally don't have school age children and leave their aging parents in other states and countries.

The rapid personal income growth outstrips the willingness of decisionmakers to spend money coupled with non-fiscal constraints on spending such as reaching agreement on facilities, obtaining sites, hiring workers, obtaining federal approvals, and the like. As a result, much of the demand goes unsatisfied or satisfied only by crowding. In California, this has meant crowded schools (pupil-teacher ratios well above the national average) and much publicized highway congestion.

The fiscal result is politically potent. It is the medicine that allowed Governor Dukakis to talk about the "Massachusetts miracle" in 1988. "Taxachusetts" was turned into an average-tax state because tax burdens shrank as a percentage of sharply rising Bay State personal income while other states didn't experience the same prosperity. It is the medicine that allowed states like Texas, Oklahoma, and Colorado to maintain low tax burdens through the early 1980s. It is the medicine that permitted Arizona and Nevada to hold relatively low taxes in the mid-1980s as they drew development from other states. It is why California could live comfortably with the Gann Amendment, a state tax-limiting measure adopted about the time of Proposition 13.

Good Times Don't Roll Forever

Extraordinary prosperity plants the seeds of its own destruction. The young workers drawn to a state have children who grow to school age. The retired population increases as the earlier migrants age. Land values and housing prices rise to extreme levels as demand outstrips supply. Wages tend to grow well above wages in competing states. Congestion becomes a problem. These factors alone would tend to prevent a state from leading national averages forever. The correction, with no outside causes, can be painful as indicated by the economic and fiscal history of Arizona during the 1980s.

> *The budget we have just signed is a very difficult budget. It is not only difficult in terms of getting it to my desk, but it is a difficult budget in that it reflects the very trying times we are experiencing, the worst economic times since the Great Depression.* —Governor Wilson signing the budget.

When the tendency of an overheated economy to unwind by itself is coupled with shocks from outside, the economic situation turns around quickly. This happened to New England states in the late 1980s, to the Oil Patch states in the mid-1980s, and to Michigan in the 1970s.

It now appears to be happening in California. The remarks of the Finance Department's chief economist to a business symposium in September describe the problem:

> *The normal sequence of economic activity that creates prosperity has turned into a vicious, underperforming cycle. Spending for consumer goods and housing depends on income and confidence which depends on job growth that depends on business confidence and business expansion which depends on the housing and consumer market. I'm not sure how we break the loop.*

August estimates show that the California unemployment rate jumped to 9.8% from 8.9% in July. The national rate was 7.6%, down slightly from 7.7% in July. California's rate was well above that of other large states. The Finance Department economist commented, "It still appears California is heading south."

> *This is a year in which we are downscaling and downsizing everything.* —Speaker Brown on the FY 1993 budget.

The pattern in other states suffering decline was to underestimate the magnitude of the resulting state fiscal problem and then to spread fiscal adjustments, both higher taxes and restraints on spending growth, over a long period. California may just be repeating this pattern. If it is, there are no implications for other states.

California Learning To Live With Slow Growth?

If California's adjustments are comparable to those of other states with similar problems, its adjustments will lag behind the evolving reality of its economy. As personal income growth lags the national growth rate, **the percentage of personal income taken as taxes will tend to rise**.

> *The people have to come to grips with the fact that what we have is a squealing pig and the tighter we squeeze it, the louder it will squeal.* Richard Gann on those who contend budget cuts hurt California.

This transition isn't automatic. It requires tax increases, like those California enacted in 1991, or substitutes for tax increases such as the many charges levied by California local governments to avoid Proposition 13's limits on property tax increases. It also requires some deviation from the Gann Amendment's limits on the growth of state taxes and spending. California voters have already approved one such deviation in the name of better highways. They may be asked to approve a second one in the name of maintaining other state services.

But if national patterns are followed, **the increases in government spending will drop below what California now defines as current services**. This tendency can be seen in the actions taken in 1991 and especially in 1992. California abandoned its tradition (and law) of automatic cost-of-living increases for welfare recipients. Whether the further cuts going before voters in November are accepted or rejected, California isn't likely to restore automatic cost of living increases.

By moving to higher tuition, California has shifted some of the costs of government to students, as is fully recognized. Less recognized is that California will be reducing the cost of government by its tuition increases and by more limited course offerings and fewer campuses than envisioned in its higher education master plan. More students are probably on waiting lists, as community college leaders claim, but also the demand for higher education is bound to drop as the price rises. Medicaid costs will be reduced from current service levels by tighter approaches to eligibility for cash assistance, lower assistance payments, and eventually more serious constraints on services. California public employee compensation, well above the national average, is already being restrained by the fiscal circumstances of state government and by shifting cost pressures to local schools.

> *We had an $11 billion hole to fill, and we were compelled to do things that no one wanted to do.* —Governor Wilson on the budget.

Governor Wilson and his predecessor placed great emphasis on a structural imbalance in the California budget. Cost cutting measures will, no doubt, further reduce the imbalance, though not without a fight. How long the state will face a fiscal situation more severe than the average state depends on how effective this effort is, as well as on how the state's economy performs. New York is suggestive of how long the situation can persist.

New York doesn't have tax burdens that are 30% to 50% above the national average because decision makers decided that result was appropriate policy. The state maintained relatively normal tax burdens, in relation to personal income or other measures of taxpaying capacity, in the days when its per capita public spending exceeded the national average by about as much as its per capita personal income. For decades now, it has been more difficult for the state to expand spending than most states because of generally slower personal income growth.

Governor Wilson and the California Finance Department discuss the long-term problem in terms of a "dependency ratio," the relationship between the size of the working age group (ages 18-64) and the number of other residents. They expect the dependency ratio to increase in California between 1990 and 2000 while it is dropping nationally. The result, according to the Finance Director:

> *Because other states will not experience the same explosive growth in the demand for government services and payments as California, the state will be at a competitive disadvantage if it raises taxes in order to meet increased demands. Tax increases may well encourage some working-age Californians to leave the state, further exacerbating the budget problem. Indeed, there is evidence that this may already be occurring.*

Crisis Budgeting

If the assessment in this article is correct, then California's actions this year, and last year, are steps on the road of adjustment that is by no means yet fully traveled. If California follows the patterns of other states, the adjustment won't be decisive in any one year. So long as there is the hope, as there will likely be every year, that the state's economic problem is temporary, there will never be consensus on either the downsizing that would be required to live without tax increases or on the tax increases that would be required to live without cutting current service spending. So one crisis may be followed by another. California's Treasurer warned in an OpEd in the Sacramento Bee (8/20):

> *Unfortunately, this crisis may just be a preview of things to come. While all eyes have been glued to budget deliberations in the Capitol, the state is also in the grips of a cash crisis that could linger far after a budget deal is struck. Because of the six-week budget delay, the lack of a "rainy day" reserve fund and the continued sluggishness of the state economy, we run the risk that the state will be unable to make ends meet through the entire fiscal year. Come spring, California could once again experience the disgrace of IOUs.*

The Impacts Of Retrenchment

California's downsizing is most severe in the areas where state spending has greatly exceeded national averages. In a national climate of freezes and inflation-level increases, California's cuts below prior year levels will appear Draconian. Those adjustments in 1992 were most apparent in cash AFDC payments, state supplements of federal Supplemental Security Income payments (to the aged, blind, and disabled), and higher education.

One view of the budget was that public higher education would get $500 million less funding than in FY 1992, but would collect $241 million more money from students. The estimate of enrollment demand that wouldn't be met — because students would be driven out by enrollment caps, reduced aid for students who already receive it and no money for new students, closed classes, and higher tuition — was 160,000 to 250,000 students. The executive director of the higher education coordinating commission commented:

> *Clearly, we need new strategies for higher education in California in the 1990s. We expect continuing financial problems and access problems, even after the state economy recovers.*

The retrenchment will affect all levels of California government. Local governments have problems of their own associated with less tax base growth than usual and the growing demands for locally provided services, particularly the local components of health and social services. The state budget shifts a part of the state's fiscal problem to local governments, though state and local officials dispute how much. One mechanism effectively shifted some of the property tax base of other local governments to school districts.

Los Angeles Mayor Bradley has indicated that he doesn't expect to seek reelection. The Superintendent of Los Angeles schools recently resigned. The school district, which serves about 650,000 students, is dealing with what its officials describe as a 10% cut. One proposal was pay cuts of as much as 16% for some workers. Los Angeles County is discussing cuts which its officials describe as reducing its budget by about 17%.

Time Heals The Wounds

The good news for California is similar to the good news that developed in other states for similar reasons. Out of adversity comes a stronger, though downsized, economy. That economy will have more well-trained workers available, lower wages, lower housing prices, and eventually less price pressure throughout the economy. With less economic opportunity to attract immigrants, migration to the state will tend to slow, relieving some of the pressures on public services. In the painful process, confidence will drop, speculative building will largely disappear, and the state could suffer a recession equivalent to that faced by New England states through much of the 1960s and 1970s. Eventually, a resurgence is likely to develop, as it did in New England and in the Oil Patch states.

California is attempting to discourage immigration to take advantage of its generous welfare and health benefits. One measure, which requires federal waivers, limits the AFDC payment to new residents to what they could have received in their previous state of residence. This lower level would continue for a year. There is also an effort to eliminate health benefits for undocumented aliens except for clear emergency situations.

Economic adversity will probably cause changes in the environment for business, as it has in other states. For example, Northeastern states such as **Pennsylvania** made major adjustments in state policies in the 1960s and 1970s. These included more aggressive industrial recruiting, new subsidies for plants exceeding competitor's abatements, and a significant reduction in the corporate income tax rate. The governor is targeting what he calls "made-in-California problems, self-inflicted wounds." One example was the Workers Compensation reform package which nearly was enacted in this year's legislative session.

State Elected Officials Not Popular

The California budget and the lengthy process by which it was developed didn't draw high marks from voters. A Field Poll taken in September showed that 53% of voters disapproved of the new budget, with 33% approving and 14% expressing no opinion. Respondents gave low marks to all the participants for their performance during the budget deadlock, as shown in the table.

Voter Perception of California Elected Officials' Performance In 1992 Budget Crisis

Elected Officials	Excellent/ Good	Fair	Poor/ Very Poor	No Opinion
Governor (R)	19%	23%	47%	11%
House Speaker (D)	16	23	39	22
Senate President (D)	10	28	25	37
House Democrats	11	33	35	21
House Republicans	11	31	34	24
Senate Democrats	13	30	33	24
Senate Republicans	12	31	32	25

While the table can be searched for nuances of opinion, the overwhelming message is that none of the participants' performances ware perceived favorably.

STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The quarterly Index of State Economic Momentum is designed to measure the performance of state economies with a single statistic. The Index sets the national average at 0%, which reflects personal income growth of 4.1%, employment loss of 0.51%, and population growth of about 0.8%. A state matches the average by matching all three components, or by any combination of deviations from them that cancel each other.

The rankings, like those of the Index published in June (Issue 12), show prosperity relative to the nation as a whole concentrated in the Northwest and West. The bottom ranks are dominated by Northeastern states. The latest Index numbers and the components of personal income and employment, shown in the sections below, show significant changes in economic leadership among the states. The changes reflect success in economic development and cause significant differences in fiscal challenges facing individual states.

Index Of State Economic Momentum, September 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	2.61%	18	Hawaii	0.64%	34	West Virginia	-0.12%
2	Idaho	2.22	19	Mississippi	0.59	35	Illinois	-0.26
3	Utah	1.70	20	North Dakota	0.58	36	California	-0.37
4	Oregon	1.52	21	Alaska	0.57	37	Ohio	-0.38
5	Arkansas	1.48	22	Tennessee	0.41	38	Virginia	-0.42
6	Washington	1.40	23	Nebraska	0.40	39	Maine	-0.51
7	Texas	1.36	24	Georgia	0.40	40	Vermont	-0.62
8	Montana	1.24	25	Michigan	0.40	41	Pennsylvania	-0.72
9	Kansas	1.21	26	Florida	0.31	42	South Carolina	-0.77
10	South Dakota	1.12	27	Alabama	0.29	43	Delaware	-1.02
11	Colorado	1.10	28	Iowa	0.22	44	New York	-1.03
12	Wisconsin	1.02	29	Missouri	0.11	45	New Hampshire	-1.04
13	Kentucky	1.00	30	Arizona	0.08	46	Maryland	-1.05
14	North-Carolina	0.89	31	Louisiana	0.07	47	Massachusetts	-1.35
15	Indiana	0.86	32	Wyoming	0.03	48	New Jersey	-1.45
16	Minnesota	0.79		**United States**	**0.00**	49	Connecticut	-1.82
17	New Mexico	0.74	33	Oklahoma	-0.07	50	Rhode Island	-1.87

Stagnation In The Northeast: Although still in the bottom third, several New England states have broken away from the bottom and the differentials between New England states and the national average has narrowed from a year ago. Both facts suggest a bottoming out of the area's recession. However, serious fiscal problems remain despite tax increases in **Connecticut** and **Rhode Island** and spending restraint throughout the region. **Massachusetts** revenues are above estimates and it has improved its bond rating. **Maine** and **Vermont** expect serious budget problems next year. The problems in **New Hampshire** are so serious that adopting a sales or income tax is being considered seriously.

Farther down the Atlantic Coast, the situation isn't getting better. Despite large tax increases this year, **Maryland** officials are debating whether their FY 1993 shortfall is more like $250 million or $500 million. Conditions in **Florida** are the worst in years, but the **Georgia** economy is OK.

More Problems In The Far West: Besides slowness in **California** and **Hawaii**, there are signs that **Washington**'s boom is slowing. **Nevada** should drop from its #1 rank when new population estimates are released this winter.

Strength In The Midsection: From **Idaho** and **Colorado** to **Wisconsin**, continuing down to **Texas**, states are outperforming the national economy. This hasn't eliminated fiscal problems, but has alleviated some of them.

Employment Picture Mixed

From June of 1991 to June of 1992, the economy lost about 555,000 jobs or about half of a percent of all jobs. The distribution of job changes was highly skewed. Gains were experienced in 28 states, led by **Texas** (which gained 75,800 jobs), **Indiana** (36.500), and **Wisconsin**, (34,300).

Losses were more concentrated, with 14 states having losses of 10,000 or more jobs. The big losers were **California** (228,900), **New York** (182,600), and **New Jersey** (97,300). The table shows the percentage changes.

Percent Change In Employment, June 1991 To June 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arkansas	2.96%	18	Alaska	0.71%	34	Florida	-0.59%
2	Utah	2.45	19	Washington	0.71	35	Oklahoma	-0.62
3	Idaho	2.40	20	Wyoming	0.70	36	Ohio	-0.65
4	Kansas	2.19	21	North Carolina	0.57	37	Virginia	-0.72
5	Montana	1.90	22	Nebraska	0.57	38	Maine	-0.74
6	North Dakota	1.68	23	Hawaii	0.48	39	Pennsylvania	-1.34
7	Nevada	1.65	24	Mississippi	0.37	40	Delaware	-1.63
8	South Dakota	1.64	25	Alabama	0.13	41	New Hampshire	-1.73
9	Wisconsin	1.48	26	Iowa	0.08	42	South Carolina	-1.73
10	Indiana	1.45	27	Louisiana	0.02	43	Vermont	-1.80
11	Colorado	1.39	28	Georgia	0.01	44	California	-1.82
12	Oregon	1.27	29	Arizona	-0.09	45	New York	-2.28
13	Texas	1.05	30	Tennessee	-0.10	46	Massachusetts	-2.31
14	West Virginia	0.96	31	Michigan	-0.12	47	Rhode Island	-2.45
15	Minnesota	0.96	32	Missouri	-0.13	48	Maryland	-2.55
16	Kentucky	0.93	33	Illinois	-0.50	49	New Jersey	-2.74
17	New Mexico	0.73		**United States**	**-0.51**	50	Connecticut	-3.44

In the unsatisfactory economic climate of the past year, any job gain was a good sign. But judged against more normal job growth of 1%, less than a fourth of the states showed significant growth in employment. With the exception of **Oregon**, the leading states are in the center of the country. The late 1980s talk of a "bicoastal economy" is clearly dead. States on the Atlantic Coast and **California** turned in the worst percentage performance. The large states of the South and Midwest — like **Georgia**, **Illinois**, and **Michigan** — are concentrated close to the national average.

Personal Income Growth Slow

Personal income in the first quarter of 1992 was 4.1% ahead of personal income one year earlier. With inflation running about 3%, real personal income growth about matched population growth of about 1%. The state statistics appear in the table.

Percentage Change In Personal Income, First Quarter 1991-1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	7.3%	18	Wisconsin	5.2%	34	Ohio	3.7%
2	Montana	6.3	19	New Mexico	5.1	35	Arizona	3.5
3	Texas	6.3	20	Indiana	4.9	36	Florida	3.5
4	Kentucky	6.2	21	Minnesota	4.9	37	New York	3.4
5	South Dakota	6.2	22	Oklahoma	4.9	38	Pennsylvania	3.4
6	Utah	6.0	23	Alabama	4.8	39	Vermont	3.4
7	Mississippi	5.8	24	Alaska	4.8	40	California	3.2
8	Oregon	5.8	25	Nebraska	4.8	41	Maine	2.9
9	Colorado	5.7	26	Nevada	4.8	42	South Carolina	2.9
10	Arkansas	5.6	27	Iowa	4.7	43	New Jersey	2.7
11	Kansas	5.6	28	Hawaii	4.6	44	Virginia	2.7
12	North Dakota	5.5	29	Wyoming	4.6	45	Maryland	2.6
13	North Carolina	5.4	30	Georgia	4.5	46	Massachusetts	2.6
14	Louisiana	5.3	31	Missouri	4.4	47	New Hampshire	2.6
15	Washington	5.3		**United States**	**4.1**	48	Connecticut	2.2
16	Michigan	5.2	32	Illinois	3.9	49	Delaware	1.7
17	Tennessee	5.2	33	West Virginia	3.8	50	Rhode Island	1.0

An Alternative Measure Of State Economic Performance

The Index of State Economic Momentum has spawned several similar indices in the years since it was introduced. The latest appeared in U.S. News (9/14). It is much more volatile than **Report**'s index because it includes housing prices and business bankruptcy rates. It also treats population growth differently. It indirectly, and probably inadvertently, treats population growth as an negative indicator by using per capita income growth and the unemployment rate as positive indicators. When discouraged potential workers leave a state and out-of-state university students never come back, the population loss reduces the denominator of per capita income and the unemployment numerator.

As a result, states like **Idaho**, **Utah**, and **Washington** have substantially lower ranks in the U.S. News index. It ranks **Hawaii** last, followed (in reverse order) by **New Jersey**, **California**, **New York**, **Delaware**, and **Nevada**. The magazine ranks **Oklahoma** first, followed by **Kentucky**, **Arkansas**, **Kansas**, and **South Dakota**.

Growth Policy And Economic Circumstances

The Index of State Economic Momentum is a good indicator of how serious state officials are likely to be about "growth policy." When state economies are booming, concerns grow over the adverse effects of growth — pollution, congestion, increasing demands on public services, rising infrastructure costs, and a fear that the old charm is being lost. Such concerns have been a major factor in **California** politics for decades. Now they are of particular concern in fast-growing states like **Washington**. But some of the policies in California are under attack as discouraging economic development.

Growth management was a major theme of Jerry Brown when he was the Golden State's governor. Subsequent governors and many legislators have had an interest in the issue. Governor Wilson, who had made part of his reputation on growth management planning as mayor of San Diego, expected to carry the theme into his administration. His interest lead to development of a growth management proposal and public discussion of it. Late last year the governor opted not to push it. As one official put it, "It would be strange to come out with a growth management program when there's no growth to manage."

Business-Oriented Tax Cuts

Concern with promoting growth, not controlling it, tends to be strongest in the states suffering the most economic adversity. **Massachusetts** provides an example. This year, Governor Weld (R) discouraged renewing a temporary increase in the income tax, so the tax was automatically reduced. He also proposed a further income tax cut, but the idea was rejected by the legislature. His new legislative proposals take a different approach. Proposed reductions will be concentrated on business: (1) the business tax credits (job expansion, investment) proposed last year but rejected by the legislature and (2) a capital gains cut. Personal income tax reduction isn't in the package. The governor told reporters:

> *With the fiscal crisis behind us, we really should let nothing interfere with job creation. My economic development plan will be targeted at that sole objective.*

The governor is also seeking direct state aid to capital-starved firms, an industrial policy of sorts. The Weld Administration is describing its plan as "rifle-shot type approaches." The Speaker (D) has expressed doubt about further tax cuts. He argues that the budget has "no wiggle room at all."

There is also an unusual moratorium on debate in Massachusetts over the November ballot initiative to require corporations to reveal how much they pay in state taxes. State leaders are looking for a compromise to cut off a debate they believe is souring business on their state.

COMPARING PER CAPITA INCOME AND LIVING COSTS

Per Capita Income: Most statistics used to measure state economic growth deal with income, jobs, and total production growth, unadjusted for population. For cross-state comparisons of the economic situation of residents, per capita comparisons are more appropriate. The most recent per capita income data appear in the table.

Per Capita Income, 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$26,022	18	Minnesota	$19,125	34	North Carolina	$16,853
2	New Jersey	25,666		**United States**	**19,092**	35	Arizona	16,579
3	Massachusetts	23,003	19	Florida	18,992	36	Tennessee	16,486
4	New York	22,471	20	Michigan	18,655	37	South Dakota	16,071
5	Maryland	22,189	21	Kansas	18,322	38	Montana	15,675
6	New Hampshire	21,760	22	Vermont	17,997	39	Kentucky	15,626
7	Hawaii	21,190	23	Wisconsin	17,939	40	North Dakota	15,605
8	Alaska	21,067	24	Missouri	17,928	41	Oklahoma	15,541
9	California	20,847	25	Ohio	17,770	42	Alabama	15,518
10	Delaware	20,816	26	Nebraska	17,718	43	South Carolina	15,467
11	Illinois	20,731	27	Oregon	17,575	44	Idaho	15,333
12	Virginia	20,082	28	Maine	17,454	45	Louisiana	15,046
13	Nevada	19,783	29	Georgia	17,436	46	New Mexico	14,644
14	Washington	19,484	30	Iowa	17,296	47	Arkansas	14,629
15	Colorado	19,358	31	Texas	17,230	48	Utah	14,625
16	Pennsylvania	19,306	32	Indiana	17,179	49	West Virginia	14,301
17	Rhode Island	19,207	33	Wyoming	16,937	50	Mississippi	13,328

As they have for years, these statistics show that states in the Northeast are the most affluent, with **Connecticut** and **New Jersey** leading the nation. Southeastern states have consistently been lowest. However, states outside the region like **Idaho**, **New Mexico**, and **Utah** also appear in the bottom ranks.

Changes In Per Capita Income: The 1991 data show a strong tendency for per capita income differentials among states to narrow. Per capita income of the six least affluent states grew by better than 4% from 1990 to 1991, well above the national average growth of 2.4%. Of the 18 poorest states, all but **Idaho** had per capita income growth above the national average. The five top states in per capita income each had per capita income growth below the national average. Viewed another way, the top nine states in per capita income growth all have per capita incomes below $16,000, well below the national average of just over $19,000.

The one-year changes in per capita income are shown in the table. The leaders are Western and Southern states. The laggards are some previously high-growth states including **Alaska**, **California**, and **Nevada**.

Percentage Change In Per Capita Income, 1990-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Montana	7.00%	18	Kansas	3.14%	34	Massachusetts	2.14%
2	Louisiana	5.37	19	Pennsylvania	3.14	35	New Jersey	2.02
3	Mississippi	4.87	20	Hawaii	3.10	36	Ohio	2.02
4	Arkansas	4.43	21	Wyoming	3.03	37	Michigan	1.98
5	Kentucky	4.42	22	Nebraska	2.88	38	Connecticut	1.95
6	West Virginia	4.36	23	Oregon	2.79	39	Florida	1.93
7	Alabama	4.29	24	North Carolina	2.77	40	Illinois	1.93
8	New Mexico	4.21	25	Wisconsin	2.70	41	New York	1.90
9	Utah	4.21	26	Oklahoma	2.66	42	Vermont	1.87
10	Washington	4.04	27	Arizona	2.62	43	Maine	1.85
11	Texas	3.92	28	South Carolina	2.45	44	Virginia	1.81
12	Tennessee	3.82	29	Iowa	2.44	45	Maryland	1.71
13	New Hampshire	3.63		**United States**	**2.43**	46	Idaho	1.55
14	South Dakota	3.52	30	Georgia	2.42	47	Delaware	1.47
15	Missouri	3.49	31	Minnesota	2.33	48	Alaska	1.46
16	North Dakota	3.22	32	Indiana	2.30	49	California	1.27
17	Colorado	3.20	33	Rhode Island	2.24	50	Nevada	0.54

Unusual population changes cause the per capita income growth comparisons to differ from economic growth comparisons unadjusted for population change. Rapid population growth reduces per capita income growth in states like **California**, **Idaho**, and **Nevada**. States like **West Virginia** can show more rapid per capita income growth because they are experiencing little population growth.

Cost Of Living Adjustments: There is a persistent demand for factors that can be used to adjust comparisons of per capita income, teacher salaries, and other information to reflect differences in cost of living among the states. For many good reasons (simply stated: no generally acceptable conceptual base, insufficient data to go with any base, differences within states often more important than differences among states), there is no generally accepted method for making such comparisons.

A modest attempt to make adjustments was recently developed by the Finance Department in Arkansas. It uses data from the 1990 Census to adjust for differences in housing costs and data on government revenues by source to make a partial adjustment for differences in taxes:

As might be expected from the methodology, the adjustments tend to improve the relative median incomes of poorer states and lessen the advantage of richer states. For example, upward adjustments of 15% or more would be made for **Alabama**, **Arkansas**, **Mississippi**, and **West Virginia**. Downward adjustments over 7% would be made in **California** (8.8%), **Connecticut** (9.3%), **Hawaii** (11.5%), **Massachusetts** (8.7%), **New Jersey** (9%), and **New York** (8.5%).

Adjustments For Taxes: The tax adjustment shows why there are substantial differences of opinion about the validity of using such adjustments in relating living standards or salaries of individual living in different states. Selecting which taxes to count in adjustments is a problem, conceded in the study. The data on some "individual" taxes include "business" taxes like sales taxes on business-to-business sales. The data exclude some taxes, such as selective excise taxes, that represent important tax burdens on individuals in some states. There are also important conceptual issues associated with adjustments. For example, how much of a state's corporate income and business personal property taxes should be considered as being shifted to in-state employees?

Even if the data were perfect, there is a problem. In FY 1989, the study finds New York imposed per capita individual taxes of $2,427 while Arkansas imposed taxes of $877. This difference is used to adjust the purchasing power of the portion of personal income associated with taxes (about 10%), giving Arkansas an adjustment factor of 62% of the national average and New York a factor of 171%. One problem is that the data are simply showing that the average New Yorker has more income than the average Arkansan, so the average New Yorker pays more tax per capita. *Such differences could exist even though persons with identical incomes in the two states had identical tax burdens.*

Differences in taxes can reflect differences in services. For example, part of the New York differential pays for smaller classes. The tax adjustment may reflect that differences and others, such as subsidized mass transit that is a major factor in lives of many New Yorkers but few Arkansans. If applied to adjust teacher salaries, the adjustment could be misleading for another reason. Even if Arkansas and New York had identical teacher salary schedules, the tax bill for Arkansas teachers would be less because: the average Arkansas teacher would fall below the average New York teacher on the schedule. In New York (with little enrollment growth), the average teacher would be older (and thus have more experience counted in determining salary) than the average Arkansas teacher.

Adjustments For Housing: The housing adjustment uses data that readers may find useful for some purposes. The 1990 Census data permit comparing states on the basis of median rents, median value of owned homes, and percentage of the population of each state that lives in homes they own. These data, presented in the Arkansas report, are combined to produce an adjustment factor for the portion of household income associated with housing costs (about 15%).

The variations in housing costs are large. Median monthly rents in 1989 varied from a high of $599 in Hawaii to a low of $215 in Mississippi. Median values of owner-occupied houses varied from $245,300 in Hawaii to $45,200 in South Dakota. The housing adjustment factors are shown in the table.

State Median Housing Costs As Percentage Of U.S. Average, 1989

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	241%	18	Florida	101%	34	Wyoming	76%
2	California	204	19	Illinois	101	35	Tennessee	74
3	Connecticut	194	20	Arizona	100	36	Idaho	72
4	New Jersey	182		**United States**	**100**	37	Louisiana	72
5	Massachusetts	177	21	Minnesota	96	38	Indiana	71
6	New Hampshire	152	22	Georgia	91	39	Montana	70
7	Rhode Island	145	23	Pennsylvania	88	40	Kansas	69
8	New York	142	24	New Mexico	87	41	Nebraska	68
9	Maryland	140	25	Oregon	87	42	North Dakota	67
10	Alaska	126	26	Utah	85	43	Alabama	66
11	Delaware	123	27	Wisconsin	82	44	Kentucky	65
12	Nevada	120	28	Michigan	81	45	Oklahoma	64
13	Vermont	115	29	North Carolina	81	46	Iowa	62
14	Virginia	113	30	Ohio	80	47	South Dakota	60
15	Washington	112	31	Texas	80	48	West Virginia	60
16	Maine	106	32	Missouri	76	49	Arkansas	59
17	Colorado	102	33	South Carolina	76	50	Mississippi	58

The differences shown on the table are massive. Four states are 40% or more below the national average and 15 states are more than 25% below average. **Hawaii**'s costs are more than 2.4 times the national average. **California**'s are twice the national average. Nine states are 40% or more above average. Part of the difference has an obvious cause. In 1989, residents of **Connecticut**, **California**, and **Hawaii**, on average, had much more money to spend than residents of **Arkansas**, **Mississippi**, and **West Virginia**. Not surprisingly, they opted to spend some of their income advantage on housing. This difference doesn't mean that *the same house* was more expensive in one of these states than another, just that *the average house* was more expensive.

Problems With The Adjustments: Adjustments of household income and especially public and private salaries on the basis of these averages doesn't make conceptual sense. For example, consider a starting teacher looking for work. If the teacher is expecting to rent a newly constructed two bedroom apartment, the cost differentials will be much smaller than these averages.

Large components of the cost of such a residence will be determined by interest rates (basically national), costs of lumber and appliances (uniform except for transportation cost differences), and construction wage rates (which differ much less than the differences shown in average housing costs). Furthermore, there is considerable variation within states. If the teacher is considering employment in the suburbs of Little Rock or Jackson, he or she may find housing more expensive than if considering employment in Upstate New York or Northern California.

Another important factor in housing cost comparisons, including the median prices reported in the press as well as those in the Census data, is their variability in relation to short and medium term economic changes. The stock of housing responds slowly to changes in demand, so current prices will deviate substantially from the costs of land and new construction in many situations. When demand expands rapidly, as it did in **California** and **Hawaii** in the 1980s, prices tend to be bid up. When the owner's alternative to sale at a low price or renting at low rates is letting a unit stand empty, sales prices and rents tend to drop as happened in the 1980s throughout **West Virginia** and in rural areas in the South and farm Midwest.

When the economic circumstances change, housing prices tend to move closer to the costs of new construction. As a result, there has been a substantial decline in housing costs in the New England states in the years since 1989, significant declines in some areas of **California** recently, and a real possibility that **Hawaii**'s recent economic slowdown will soon translate into higher housing costs. The reverse is true in states that have experienced more growth, notably **Oregon** and **Washington**, as well as some of the Southeastern states that have been experiencing steady growth.

MISCELLANY

Counting Population

The Census Bureau's decision on which 1990 population estimates to use to estimate state populations in the 1990s (Issue 17) has been postponed until after the November elections. The Bureau will now accept public comments through mid-November and make a decision after the end of the comment period. The choice remains whether to start the year-by-year estimates from the 1990 Census official count or from 1990 estimates corrected for "undercounts," which would add much more population in Sunbelt states than elsewhere.

Counting Tax Increases

Sharply conflicting estimates used in the Presidential campaign of how often Arkansas raised taxes while Governor Clinton was in office underline the imprecision of tax increase calculations. President Bush used about 130 increases while at the same convention Governor Engler used a number half that size. The Arkansas Department of Finance and Administration has developed a tabulation of 127 increases of which 34 were tax increases and the rest fees, but it points 73 tax cuts as well. The President's research was based on an annual tax handbook published by the Arkansas legislature. The larger counts include fee increases such as those relating to court costs and fees for reproduction of birth certificates. One count includes increased revenue associated with lengthening the dog racing season. There are similar problems in counting Bush tax increases, such as whether to count the revenue measures in the 1980 budget agreement as one tax increase or 30.

In attempting to sort out who was correct, some journalists began offering their own interpretation of what constitutes a tax increase. For example, the Boston Globe (8/28) described "the common definition, one involving broad-based levies that increase the amount most people must pay." By that definition, cigarette tax increases which are paid by a minority of the population wouldn't be counted as tax increases though they are counted by all scorekeepers of tax increases.

The definition problems will be particularly noticeable this year as national comparisons are issued from various sources. NCSL counts renewals of temporary taxes and health provider taxes in at least some states as increases. SB&TN and the Center for the Study of the States ignore renewals but SB&TN counts provider taxes while the Center and the Census Bureau don't.

Higher Education Gets The Message

The University of California budget was probably cut more than it would have been had it not been voted upon at the same time UC was embroiled in controversy over excessive spending on executive pay and perquisites. Legislators and the press clearly didn't buy the argument that having some of these expenses paid out of foundation money made them less real or relevant. In early September, UC's president announced elimination of regular use of first class air travel, reimbursement for business meals with other university employees except where a clear business purpose was documented, and purchases for personal use such as wedding gifts and personal clothing. Critics suggested it was too little, too late.

Public Opinion

A recent Wall Street Journal/NBC News poll (WSJ, 9/18/92) suggests that voters, who often have fierce objections to proposed tax increases, are relatively uninterested in lowering the current level of taxes. Though the poll asked about federal policy, the attitudes presumably apply to state taxes as well. A large sample of voters was asked, "If there were a choice on the best way to use $25 billion of federal funds, which approach would you favor?" The three options presented and the percentages favoring each were: (1) "invest in job training, education, and transportation, 56%, (2) "reduce the deficit," 31%, and (3) "an across-the-board tax cut," 10%.

The same voters were asked to identify which of six listed economic issues they considered most important. Unemployment drew nearly a 50% response, followed by the federal deficit (about 25%), and the trade deficit, inflation, federal taxes, and interest rates — all with less than 10%.

University Tuition Prepayment Plans

Led by Michigan, some states have established special savings plans designed to allow parents, grandparents, and others to put aside savings with a guarantee that they will cover in-state tuition costs when a child is ready to enter college. The plans have been popular in many of the states that have adopted them. For example, **Florida** has about 150,000 contracts in effect. These plans have run into several difficulties.

The plans set the costs of guarantees based on: (1) the number years between contributions and when a child would enter college, (2) the interest the state expects to earn on investment of the contributed funds, and (3) the rate of increase in university tuition. The plans were established when the expected increases in state university tuition were, as they had been, reasonably close to the inflation rate. This assumption is proving incorrect in the many states that have translated fiscal problems into much more rapid tuition increases. The assumed interest rates when plans were established were generally much higher than current interest rates. As a result, the amounts that need to be contributed must rise. **Florida**, for example, recently announced an increase of 13%, raising the cost for a guarantee for a newborn child to $5,150 for a contract good for four years at a state university.

The initial **Michigan** plan also presumed a favorable ruling from the IRS on federal tax treatment of the interest earnings. The tax issues are complex and decisions may be subject to change. At the moment the federal tax treatment is less favorable than presumed when the plan was adopted. As the case stands under a federal district court decision in July, the buyers of the tuition contracts won't have interest income imputed to them, but the state's trust itself isn't tax-exempt.

Anticipation of these difficulties were one of the reasons why opposition to the plans developed in many states. However, if the plans are set up so that each new year of contracts has prices based on then current assumptions, there is no inherent reason why the plans aren't feasible. Obviously, as the costs of the contracts rise, the demand for them is likely to be reduced.

When States Run Out Of Cash

California's widely publicized use of registered warrants (IOUs) to pay bills ended as budget approval cleared the way for over $3 billion in short term borrowing. Over $3 billion of the IOUs were issued in FY 1993 while the budget remained under consideration in the legislature. They are now being redeemed quickly. As the controller indicated in announcing his staff would work around the clock to clear back obligations, "I want this embarrassing chapter of California history behind us as quickly and smoothly as possible."

Although there is already talk of using the IOUs again, they are unlikely to be copied by other states as a substitute for short-term borrowing or simply delaying payment of tax refunds and vendor payments. With interest of 5%, the IOUs were more expensive than short term borrowing, as indicated by the 3.5% interest rate on the California notes. They also cause higher administrative costs, as interest must be calculated and paid on a large number of small obligations rather than one large one. They created considerable inconvenience for the public, particular through most of August when some major banks weren't accepting them, requiring the state to move to back-up measures such as accepting them for money owed the state. They unquestionably created much more negative publicity for California than other states with similar cash problems (e.g., **Illinois**) incurred by using less novel devices.

TECHNICAL NOTES

California: The assessment of California's dependency ratio is summarized in NCSL's Fiscal Letter (July/August) in an article by Finance Director Thomas Hayes. The Field Poll was reported in the Sacramento Bee (9/16).

Index Of Economic Momentum: The index is the average of the differences between each state's one-year change and the national change in (1) population, (2) personal income, and (3) employment. The measure shows how each state's economy is performing in relation to the nation and the other 49 states. Employment data are from the Bureau of Labor Statistics. Personal income and population data come from the Department of Commerce. The population change is from mid-1990 to mid-1991. The employment and income components are shown in separate table in the article.

Personal Income: The personal income data are estimates from the U.S. Department of Commerce, based on independent estimates of total personal income and of population. Links of income and family characteristics are based on individual household surveys, particularly the Census of Population. It was last taken in 1990, with information from a large sample of households on economic circumstances during 1989.

The data on adjustments for housing costs and taxes discussed in the text are based on an analysis of these data by Lawrence Santi issued in Arkansas Fiscal Notes in July (published by his employer, the Arkansas Department of Finance and Administration, Economic Analysis and Tax Research, P. O. Box 3278, Little Rock, AR 72203) and as a separate paper ("Household Income In The United States") in August. For a more elaborate attempt to adjust for cost of living differences see, Herman B. Leonard, By Choice Or By Chance?: Tracking The Values In Massachusetts Public Spending (Pioneer Institute, 21 Custom House St., Boston, MA 02110, 1992).

Besides the material covered in the article in this issue, Santi's paper includes a comparison of inflation-adjusted median household income growth from 1979 to 1989. The data have limitations. State comparisons are affected by changes in average household size which undoubtedly haven't affected all states equally and by use of a nationally uniform inflation factor, even though inflation may not have affected residents of all states equally. Some illustrative states are shown in the table.

Median Household Income, 1989, and Real Change, 1979 to 1989

State	Income (1989)	Income Rank	Change	Change Rank
Arkansas	$21,147	48	3.3%	20
California	35,798	8	17.1	9
Connecticut	41,721	1	24.0	3
Illinois	32,252	12	-0.4	28
Massachusetts	36,952	6	25.5	2
Michigan	31,020	15	-3.7	42
Mississippi	20,136	50	-0.7	33
New Hampshire	36,329	7	27.4	1
New York	32,965	11	18.2	8
Texas	27,016	32	-3.5	40
Wyoming	27,096	31	-19.1	50
United States	**30,056**	**n/a**	**6.5**	**n/a**

As the states shown illustrate, the 1979-1989 period picked up two major economic phenomena that are now completed: (1) the rapid growth experienced by states on the Atlantic and Pacific Coasts and (2) the impact of the sharp mid-1980s reduction in oil prices on Oil Patch states.

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STATE POLICY REPORTS

VOLUME 10 **ISSUE 19**

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State tax increases, an unmentionable topic this fall, may become the hot topic of 1993. Sharp spending cuts are the alternative. Doing without either now appears untenable for many states. Bond ratings reflect the situation.

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Not every state faces average problems. Some states should escape 1993 without wrenching fiscal adjustments. Most will face unpleasant options, partly because their officials choose easy options this year and last year.

- Which States Have The Worst Problems? p. 5

State policy for health care seems to be falling into a pattern that few decisionmakers are stating explicitly but many are following. States will do what they can to provide health care and cover the uninsured, but only if other health care customers or federal government programs pay the extra costs.

- Health Care On Shoestring Budgets p. 11

While **Reports** sees little new in state health care financing besides making some health consumers and the federal government, not taxpayers, pay added health costs of the poor, many observers see state leadership, innovation, and even solutions to the national problems in health care finance. Why such a difference in views?

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October 1992 (First Of Two October Issues)

ASSESSING STATE FINANCES

Look For Big Tax And Spending Changes In 1993

State finances are in poor shape, with little prospect for immediate improvement without decisive corrective actions by state officials.

Many states have run out of temporary palliatives. Hope for relief from federal action or sharp economic growth is fading. Most states will have legislators as far positioned from the next election as they can be. These circumstances suggest that 1993 will see much more serious debate over permanent fiscal adjustments than experienced this year. Such adjustments could be higher taxes, or reductions in spending patterns, or combinations of the two.

Why Fiscal Adjustments Seem Likely In 1993

Simply stated, most states have not fully adjusted to the factors adversely affecting their finances including: (1) economic stagnation, (2) sharply rising workloads as measured by prison populations, child abuse cases, and welfare and Medicaid participants, (3) a resumption of school enrollment growth after the stability of the 1980s, (4) few increases in federal aid outside of entitlements for welfare and Medicaid, (5) federal mandates increasing state and local costs. The most costly mandates aren't new ones but older ones with phased implementation. Their costs are now being felt in Medicaid eligibility, standards for health care providers, solid waste disposal, sewage treatment, services for the disabled, and other fields.

Slowness in adjusting to a changed fiscal environment has been exacerbated by special circumstances affecting state decisions in 1992 and, to a lesser degree, in 1991. Those circumstances will shift in 1993. They have included:

- **Fear Of Voter Reaction**: Legislators have always tried to avoid upsetting voters in election years by sharp spending cuts and tax increases. The normal fears were worse in 1992 because anti-incumbent sentiments have been at record levels and many legislators faced new constituents in reapportioned districts. Examples: legislators in **Maine** with a moratorium on partisan fighting over the budget, normally pro-tax legislators rejecting governor's tax proposals in **Illinois** and **Ohio**, and pro-tax legislators in **California** backing down when faced with a governor insistent on no tax increases.
- **Hope For Rescue**: Many state officials refused to believe that their state's economy would perform as poorly as it has, that welfare rolls would mushroom, that health care costs couldn't be controlled, and/or that the national economic stagnation would continue.

The optimism was particularly strong where problems appeared recently, as in **California**, and weak where the economic problems are long-standing, as in **Massachusetts**, **Mississippi**, and **West Virginia**.

- **Temporary Rescues**: Many states found fiscal salvation in health care finance: (1) retroactive Medicaid claims, (2) substituting cost-shared Medicaid for 100% state and local money in financing state institutions and public health services, and (3) the ease of enacting health care provider taxes without having them labeled tax increases. **New Hampshire** is the best example.

  Other states dealt with potential problems with reserves and rainy day funds husbanded for exactly the circumstances they faced. An example is **Indiana.**

- **Left-Over Good News**: Many states are still experiencing substantial, but not sustainable, budget relief from two favorable developments of the 1980s. The first was pension fund investment performance that outstripped actuarial assumptions. This permitted reductions in state employer contributions and improvements in local finances, making state aid freezes and cuts more palatable. **New York** was particularly benefited by this factor.

  The second was a continuing rise in taxable property values. This occurred even after market values ceased to increase because assessments lag market values in most states. Higher values make it easier for states to shift their problems to local governments as local officials can raise revenues without raising tax rates. In most school aid formulas, higher local values mean less state aid is required to meet state obligations. This factor helped in the Northeast, where the trend is now reversed, and in many Midwestern states.

- **"Bridge Financing"**: The concept of a bridge, spanning a low point between two higher points, is common in private financing, such as financing equity in a new house while an old one is being sold. The same concept rationalizes many state fiscal palliatives used in 1992 such as reducing balances and reserves below normal levels, borrowing from the marketplace or other state funds, asset sales, accelerating revenues, and retarding spending. Such bridges, used extensively in states like **California** and **Illinois**, only work if there is high ground on the other side.

These factors, with the exception of health care provider taxes, won't be significant in 1993 in most states. Elections will have been held. Optimism about state revenues and spending will be replaced with actual results, generally worse than forecasts. Optimism about 1993 will be tempered by a lower base from 1992 for revenue growth and a higher base for spending. Hopes for federal action can be tested against the budget proposals of a newly elected President. Good news about pension fund investments and assessed property values will be replaced with bad news. One-time palliatives will be replaced by the reality that last year's one-time financing is this year's addition to shortfalls.

Outside Help Probably Isn't On The Way

It is possible that state officials can escape the problems with help from two sources they can't control, the national economy and federal aid.

Most fiscal problems would be solved by a rapid economic recovery, such as real economic growth approximating the 6% annual increases experienced after some recessions. Few economists expect such growth. Reasons: (1) because the economy didn't fall as far in this recession as in some earlier ones, the recovery won't be as dramatic, (2) no major driving force, such as a war or pent-up demand for capital goods is on the horizon, (3) prosperity in other nations can't pull the U.S. economy upwards because those economies have problems of their own, and (4) the federal deficit makes massive federal pump-priming unlikely.

Federal action, such as a takeover of the state share of welfare programs or national health insurance, could provide a bailout for state finances. Nothing like this is in the cards. Even advocates of such actions minimize the immediate federal costs of their proposals by requiring the maintenance of state and local funding levels.

Early Signals of Problems

Don't look for many state officials to announce bad news before the November elections. It's not that the news isn't there, just that the timing for recognizing it is bad.

There are exceptions from state officials not seeking reelection, like the warnings from the governor of **Washington**. There are exceptions from states with strong traditions of recognizing and dealing with spending overruns quickly, such as Medicaid in **Arkansas** and **Nebraska** and school aid in **Texas**. There are also exceptions in states with problems too serious to deny or strong traditions quickly responding to potentially unbalanced budgets. Examples are the governor's administrative cutbacks in **Maryland** and **Ohio** and the actions of the Budget and Control Board in **South Carolina**.

Bond Ratings

Bond rating changes suggest the significant change in the fiscal position of the states. In 1991, Standard & Poor's issued more downgrades than in any other year in the past three decades.

Rating for states have been stable for decades. From 1962 to mid-1992, S&P upgraded 45 state ratings while downgrading 48 ratings. In the same period, Moody's raised 44 and lowered 46. In 1991, S&P dropped the ratings of eight states while Moody's dropped one. There has been more downgrading this year, including **California** and **Illinois**, but an upgrade for **Massachusetts**.

WHICH STATES HAVE THE WORST PROBLEMS?

Assessing 50 State Fiscal Situations

Many people could use an objective measure to determine which states will face fiscal problems in 1993. It would pinpoint states where taxpayers should grab their wallets, employees should worry about layoffs, universities and local officials should worry about cutbacks, and those who sell health and child care services to states should worry about reimbursement rate cuts and slow payments.

The number of states listed would depend on the outlook for the national economy and federal actions. Given assumptions about those factors, picking individual states objectively would depend on many factors, each state's (1) economic outlook relative to the nation's, (2) revenue system's ability to capture economic growth, (3) demographics, particularly enrollment growth and welfare participation, and (4) past fiscal decisions on subjects like reserves, rainy day funds, pension plan funding, and one-time financing measures. No one holds such data for all 50 states on a comparable basis.

While observers don't have data for precise measurement, they have enough knowledge of state fiscal conditions to make summary assessments. Based on the analyses in **Reports** and the state coverage in State Budget & Tax News, **Reports** can probably assess fiscal circumstances about as well as anyone who can discuss them publicly (experts paid by state dues cannot). While not a substitute for the detailed assessments many readers make of the states where they operate, the discussion in this article is probably a reasonably accurate assessment of how individual states relate to each other and national patterns.

Most States Face Serious Problems

The fiscal condition of the states can be divided into broad categories which aren't rigorously defined but are clear enough to represent meaningful distinctions.

About 17 states have decent, though tight, conditions. Eleven states are experiencing enough economic growth, despite national conditions, to be able to do their fiscal *business as usual*, that is, the way most states were able to operate in the late 1980s. Another six states are in situations that are *probably OK, but unpredictable*. These are small states with resource-oriented economies, most with large mineral trust funds that could be tapped as an alternative to tax increases or spending cuts.

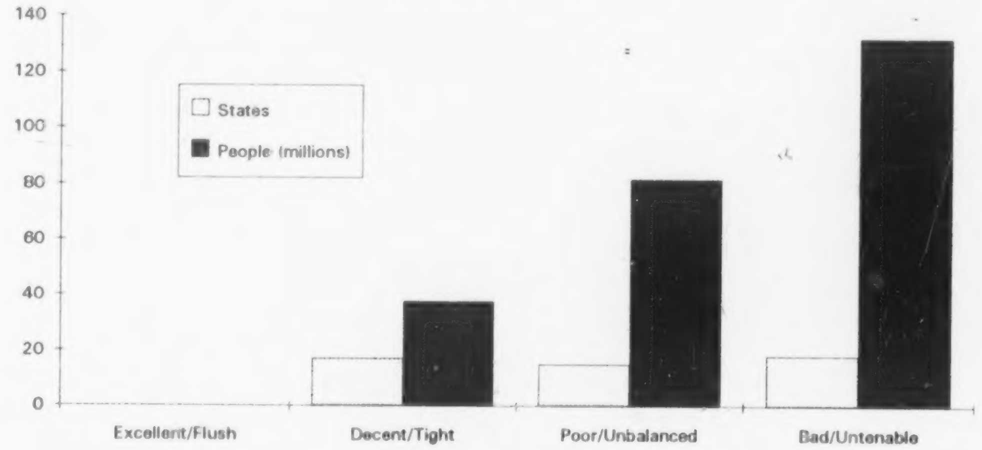
About 15 states are *close to the national average*. This isn't good as the national pattern suggests poor conditions with many FY 1993 budgets unbalanced and FY 1994 budgets aren't likely to be balanced with significant adjustments in spending and/or taxes.

About 18 states are in bad straits. Their fiscal policies appear untenable. That is, they won't be close to being able to continue current spending patterns with revenues from current taxes. Thirteen states have the *most serious fiscal issues* because of varying combinations of unusually poor economic conditions, demographic pressures such as unusual enrollment increases and welfare participation, and past failures to downsize government or increase revenues. Another five states aren't suffering as much from economic and demographic factors but have *self-imposed fiscal problems*.

Most People Live In States With Problems

Fiscal problems are disproportionately concentrated in the most heavily populated states. While about a third of the states have decent fiscal situations, only about 15% of the nation's population lives in those states. Over half the nation lives in the 18 states identified as having untenable fiscal circumstances. The contrasts are shown graphically below. The chart includes a new category, reflecting the fact that no states are classified as being in excellent condition. The category is for states that could comfortably consider costly initiatives without raising taxes or significant tax cuts without cutting current services.

Post-Election Fiscal Conditions



Business More Or Less As Usual (eleven states):

About a third of the states can probably handle their fiscal decisions in 1993 without wrenching adjustments in taxes or spending. Of course, they will all have problems because demands for spending will inevitably exceed revenues without new taxes.

Some may opt to raise taxes, but less out of necessity to continue current programs than because of decisions to lower other taxes, to spend more on schools, to provide earmarked funding for highways, to discourage cigarette consumption and fund special health programs, and/or to make health consumers pay for increasing costs of health care for the poor. Some may opt to cut current service spending levels in some programs to permit increases elsewhere and/or for policy reasons. Examples: cutting aid to cities and counties in the name of austerity and rationalizing responsibilities for delivering and financing services, cutting welfare in the name of welfare reform, and cutting higher education in the name of higher priorities elsewhere and more reliance on tuition.

Some of these states have made promises — explicitly in legislation or less explicitly by expectations and campaign promises — which they won't be able to keep without tax increases or sharp spending cuts. Examples are escalation in spending in multi-year school aid formulas and scheduled tax cuts.

Even among these more prosperous states, **there appears to be no state where significant state tax cuts will be adopted in 1993**, not counting cuts in one tax financed by increases in another.

The states likely to have the easiest time with their finances have three characteristics. First, their economy is outperforming the nation, generally showing employment growth of 1% or better in the last year. Second, they haven't dug an extraordinarily deep fiscal hole for themselves by borrowing, spending delays, large overestimates of revenue and underestimates of spending, and use of one-time budget balancing measures. Third, they haven't shot themselves in the fiscal foot by state court decisions or voter initiatives. These relatively fortunate states are:

Arkansas
Colorado
Idaho
Indiana
Kansas
Kentucky
Minnesota
New Mexico
Utah
West Virginia
Wisconsin

Probably OK, But Unpredictable (six states)

Some smaller Western states have unpredictable finances for several reasons. First, their economies and state revenues relay heavily on resources such as oil, gas, minerals, timber, and agriculture. As a result, their finances are highly subject to rapid fluctuations in world prices and prospects for these industries and to unpredictable national policy changes. Second, their tax systems are unbalanced, lacking taxes on personal income and/or on sales, making revenues more volatile than those of most states and creating constant pressures to adopt the missing taxes and reduce other tax burdens.

Third, their decisionmaking is less predictable. They often decide policy by initiative and referendum. They have unusual tendencies to intersperse periods of highly partisan stagnation with periods of consensus on rapid change. Fourth, most of these states have large mineral revenue trust funds with fiscal flexibility available should they decide to divert revenues to operations or raid principal. The economies of these states are in reasonable condition by national standards, though growth, particularly in Nevada, is below past levels. The states:

Alaska
Montana
Nevada
North Dakota
South Dakota
Wyoming

Close To The National Average (15 states)

These states are experiencing about the same sluggish economic performance as the nation as a whole. They share the kinds of problems described earlier in this article as leading to fiscal problems as early as now and as late as in their FY 1994 budgets to be considered next year. Most need large tax increases if they are to fund current service budgets as they define them locally — including legislated school aid increases, negotiated pay raises, scheduled tax cuts, and spending increases mandated by state courts or agreed to in federal court consent decrees. Put the other way, they need major cuts in spending patterns and to renege on some promises to avoid large tax increases. They are:

Arizona
Georgia
Hawaii
Illinois
Iowa
Michigan
Mississippi
Missouri
Nebraska
North Carolina
Ohio
Oklahoma
Tennessee
Virginia
Washington

States With Most Serious Fiscal Issues (13 states)

The states on this list are experiencing economic performance well below the national average. While some of them have already made significant adjustments in taxes and/or spending patterns, they probably will have to face another round. They are:

California
Connecticut
Delaware
Maine
Maryland
Massachusetts
New Hampshire
New Jersey
New York
Pennsylvania
Rhode Island
South Carolina
Vermont

Some of these states have done much better than others in making fiscal adjustments. All but perhaps **Maryland** have austere budgets.

Most have enacted large tax increases, most notably the new income tax in **Connecticut**. Previous large increases in **Massachusetts**, **New Jersey** and **Pennsylvania** were partly rolled back this year, leaving tight finances in all three. **Massachusetts** and **Rhode Island** have sharply cutback local aid as well as increasing taxes. **New York** has been adjusting to slow growth for years with mild tax increases, postponing scheduled tax reductions and spending increases, tuition increases, and austerity in spending for local and many state operations.

The adjustment process is least complete in **California** (where economic performance has been particularly poor and unexpected), **Maine**, **New Hampshire**, and **Vermont**. In the Granite State, which has survived only with unusual austerity and a windfall from Medicaid reimbursements, enacting a state income tax is a serious prospect.

States With Self-Imposed Fiscal Problems (five states)

Five states have special fiscal problems which developed out of state action and inaction with major fiscal impacts. From the perspective of outsiders, the conditions are self-inflicted because they were imposed by some form of state action. From the perspective of legislators and governors of these states, the conditions are uncontrollable because they are imposed by state constitutions, state voters, and state courts.

Alabama creates an automatic fiscal problem in its general fund by earmarking its best revenue sources for education. It pushed its legal risks to the limits last year by continuing two taxes (insurance premium and corporate franchise) that probably violate the U.S. Constitution's prohibition against state actions discriminating against interstate commerce. It pushed again by balancing last year's budget with differential fees for out-of-state and in-state hazardous waste disposal. They have already been adjudicated as unconstitutional. The state is also pushing the limits for creative financing of Medicaid. A major tax reform effort failed last year after passage by the House. A special session is being held this year to deal with fiscal problems, with reconsideration of tax reform (and increases) scheduled for early next year.

If the concept of budgets with *structural imbalance* were not already in use, someone would invent it to describe **Florida** finances. Demography has caught up with state spending, with rapidly rising school enrollments, increasing demands for university slots, and immense demand for infrastructure including roads, schools, and public buildings. A tax system designed to protect residents with a homestead exemption and a constitutional prohibition against taxing personal income won't accommodate the spending needs without less public service than Florida voters seem to want or further increases in taxes on the types of business the state seeks to encourage (e.g., manufacturing and tourism). This year, the governor sought $1.3 billion in new taxes and compromised on about $300 million. Next year, the same issues will be back.

After many tries at tax reform in the late 1980s, **Louisiana** settled into high reliance on business taxes, oil and gas revenues, and a highly regressive sales tax that is still considered "temporary." Major change was out in 1991, an election year. Tax changes weren't seriously considered in the legislative session this year because of a constitutional convention oriented to tax matters being held in the fall. With tax policy and levels undecided, legislators didn't cut back spending patterns, some of which (e.g., school aid) are enshrined in the state's constitution. The constitutional convention hasn't produced tax recommendations likely to solve the fiscal problem. Status quo financing in 1993 is out of the question without unanticipated increases in oil and gas prices.

Voters in **Oregon** have consistently complained about their high income and property taxes. But for decades they have rejected proposals to replace part of property tax revenues with a new sales tax. With enactment of Measure 5, they may have started a process that ends with a sales tax, but getting there won't be fun. The voter-initiated measure starts to bite heavily in the new biennium when rolled back property taxes are supposed to be replaced by large increments of state aid. Without tax increases or more economic growth than appears likely, the result would be one of the nation's most austere state budgets. But voters may not believe this until they see it. So they may see it. Or, legislators may decide to put a sales tax on the ballot. The governor suggested just that earlier this year, but the legislature rejected her proposal.

The **Texas** economy is doing fine by national standards. Texas finances suffer from high reliance on declining oil and gas production and sales taxes on goods. The state could probably slide by the new biennium by relaxing its Texas-size standards for universities (world-class), tuition (low), cash in trust funds (high), the percentage of population incarcerated (high), and selectively broadening its sales tax. It could create a fiscal crisis by moving to national averages in welfare payments (extremely low), welfare and Medicaid eligibility (low), and public sector salaries (relatively low). These issues are academic because the latest school finance arrangement has been held by state courts to be unconstitutional. It is based on property taxes that can't be collected after next summer.

Signs Of The Times?

The latest Department of Commerce estimates of state and local finances (second quarter of 1992 at seasonally adjusted annual rates) bring discouraging news about current fiscal conditions. The state and local deficit, excluding trust funds, is running at an annual total of about $40 billion. The deficit level is slightly below the revised estimate for the first quarter of 1992, but higher than in the fourth quarter of 1991. Pension funds, which should be adding assets rapidly to cover future retirement obligations, show a smaller surplus than any recent previous quarter. With lower interest rates, governments are earning less interest. With more debt, they are paying more interest.

HEALTH CARE ON SHOESTRING BUDGETS

Introduction, A Pattern Emerges

In late September, the Ohio legislature approved new taxes in a pre-election action that excited little controversy. By votes of 89-6 in the House and 37-1 in the Senate, the legislature revised its "care assurance" program. The legislation was sold on the basis of being necessary to comply with current federal Medicaid regulations and unavoidable for the state to continue current reimbursement levels for hospitals. It was a revision of Ohio's provider donation program adopted in 1988, but clearly takes the form of taxes that redistribute purchasing power. The lone dissenting vote in the Senate was from a Senator representing a Cleveland suburb which, for the first time, would find its major hospital (and thus its residents and their employers) contributing more in taxes than they received in Medicaid financing.

Ohio's action, and similar ones in other states, illustrate the increasing acceptability of provider taxes to legislators, governors, and health care providers. Officials of nearly every state are convincing providers, particularly hospital administrators, that neither additional state general fund money nor new taxes are likely to be available to finance escalating Medicaid costs and certainly not to raise reimbursement rates to levels the providers seek.

> *There's no way on God's green earth that the legislature will raise taxes again, so soon after 1990's tax hikes for school reform. And why should it? To further line the pockets of health-care providers? What fool of a politician would propose such a massive transfer of wealth, from all of us to some of the wealthiest among us?* — Columnist Robert Garrett, Louisville Courier-Journal (9/20).

Meanwhile, inaction is demonstrating that state officials are unwilling to make a deep plunge into financing programs for the uninsured outside of Medicaid. At least not using state money. Instead, they are looking for ways to convert costs of existing programs from financing by state and local taxes alone to federal-state cost sharing through Medicaid.

Easy Outs Are Out

If not state money for health care, then whose money? The two choices have always been the federal government and private employers. Neither choice is realistically available to state officials.

Making Employers Pay: Mandating employers to provide care, as many nation's do, isn't a tenable state policy if large employers can easily opt not to participate. They can, by shifting from buying insurance to self-insurance. Many are now making this shift just to avoid state mandates on what services must be covered and to avoid state insurance taxes. States cannot reach self-insurance by their powers over insurance because technically no insurance is purchased. States cannot reach self-insurance through their general legislative powers because such action is preempted by the federal Employee Retirement Income Security Act (ERISA). Efforts by the governors to get Congress to end the preemption, which are opposed by many groups, haven't been successful and have poor prospects.

It is conceivable that states could force employers to provide health plans for employees by use of the power to tax. This "play or pay" concept was the basis of the plan adopted by **Massachusetts**, but never implemented. The concept would, at a minimum, result in litigation with uncertain outcomes. More significant, state officials have been unwilling to subject their employers to required costs of 3-7% of payroll when employers in competing states aren't faced with such costs. The sole exception so far, **Hawaii**, enjoys a natural protection from interstate competition afforded by geography and protection from federal preemption because it has an exemption from the ERISA legislation.

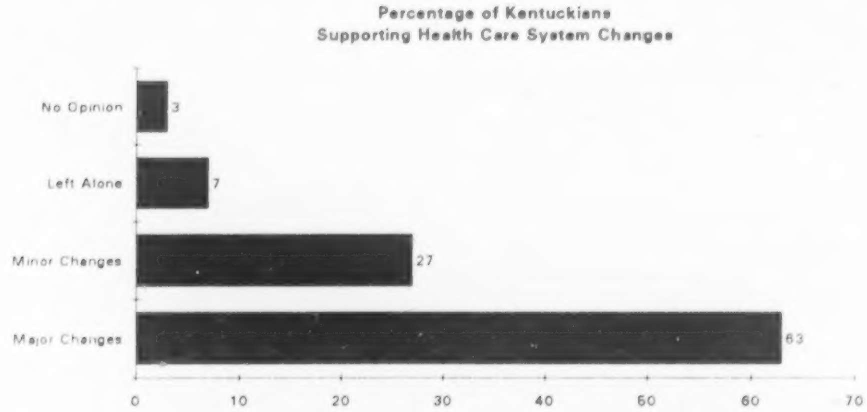
Making The Feds Pay: As readers are aware, health care financing is a major issue in the Presidential campaign and Congressional races. But, regardless of who is elected, state officials have little basis for predicting what the federal government will do. The range of possibilities is broad, from doing nothing to a full-scale national plan ending Medicaid and preempting all state health insurance mandates and indigent care programs. The possibility of federal action discourages decisive state action while the uncertainty about the form action will take discourages state action anticipating new federal action.

The Political Environment For State Action Is Poor

Public opinion presents major hazards for state initiatives to revise the health care system. A recent poll illustrates the ambivalence in public thinking on health care.

There is strong sentiment for change. A sample of Kentuckians was asked, "Do you think there need to be major changes in our health-care system, minor changes, or should the system be left pretty much the way it is?" The results (see chart, p. 13) show overwhelming support for change with little opposition and only 3% with no opinion.

The poll also indicates a high level of personal concern with ability to pay for care. About 20% of Kentucky adults said they were without health insurance at some time in the last year. About half of all Kentuckians with insurance say they worry "a great deal" about having to pay expensive bills not covered by their policies, 38% worry "a great deal" about having to pay larger premiums, and 37% worry "a great deal" about losing their coverage.



The problem for reformers is illustrated by the poll's question, "How do you feel about the health-care services that you and your family have used in the past few years?" About two-thirds of Kentuckians were satisfied with only a third dissatisfied. Having a large percentage of the population satisfied with their own personal arrangements while favoring changes in the broader system means that proposed reforms are vulnerable to attacks suggesting that the proposed reform would upset the existing arrangements. For example, a majority of Kentuckians would not enroll in a plan that would limit their choices of doctors and hospitals.

Satisfaction with existing personal arrangements and lack of consensus on possible reforms creates tremendous opportunities for any group dissatisfied with reform proposals to kindle opposition. Even simple measures like health care provider taxes are vulnerable. For example, Governor Wilder's early proposal was shelved after Virginia hospitals purchased advertising labeling it as a "sick tax." Without such opposition, the provider taxes have passed easily. State officials have dealt with the situation by making creditable threats that reimbursement rates would drop without provider taxes and promises they will rise with them. Easy passage of the proposals late in this year's legislative sessions in **Illinois** and **Rhode Island** are examples.

Consensus Is Hard To Forge

Because the politics of the situation seems to demand consensus involving major health care providers, state officials have opted for commissions and task forces designed to forge consensus. Some of these have failed. Others have found consensus only by agreeing on plans involving massive new resources from employer mandates, state general fund taxes, or both. The legislators being asked to vote the mandates and new taxes haven't been part of the consensus.

Many of the state commissions and task forces of the late 1980s have reported and been disbanded without noticeable impacts. Probably the best run at a commission-recommended plan was in **New Jersey**. The group's recommendations, presented in 1990, had strong support from key leaders of major firms, labor unions, and health care providers. Impetus for action was provided by the scheduled expiration of the unpopular and expensive surcharge on hospital bills to pay for uncompensated care. The plan fell to small business opposition to mandates and taxes and legislators' reluctance to impose new levies soon after raising sales and income taxes, which they correctly perceived would prove unpopular.

Currently active commissions are having difficulty forging consensus. The **Iowa** Leadership Consortium on Health Care has been meeting for two years under the leadership of a popular former governor. Disputes broke into the open in August, when the National Federation of Independent Business and major employers (e.g., Deere & Co. and Pioneer Hi-Bred) publicly objected to the group's central thrust. The **Texas** Health Policy Task Force recently backed off strong support of a single payer plan because of insurance company opposition. The **Washington** Health Care Commission has been working for two years against a deadline of this November. Agreement is unlikely. A key legislator is pushing a ballot proposal with one plan, physicians have another, insurers have another, and yet others are being discussed.

This year's **Florida** plan is actually just a plan to make a plan. The new Agency for Health Care Administration is supposed to recommend a plan by the end of this year. But the governor and others see federal legislation (ERISA exemption and Medicaid flexibility) as critical to achieving the goal. Advised that Congressional action this year was unlikely, the agency head commented, "We said from the beginning we couldn't get there {affordable health care for all} by ourselves." He plans to submit two proposals, one assuming federal action and one assuming federal inaction.

State commissions continue to be appointed. **South Dakota**'s governor recently appointed members of the commission established by legislation this year. The group is expected to be making recommendations through 1995, with some hope it will have reform proposals for the 1993 session.

Little Funding For Prevention Programs

> *Why not increase preventive care to reduce costs? Because, as there are never enough funds to satisfy current needs, then there are certainly too few dollars to embark on meaningful prevention programs. Ideally the states should be spending for prevention. Realistically they will not be.* — Robert Mandeville, former Illinois Budget Director, OpEd Chicago Tribune (9/28).

State elected officials have long stressed the concept that prevention is a cheaper, more humane, more cost-effective, and generally superior approach to health than spending on health care after health problems have developed. Public health experts, in and out of state government, and citizen groups have a long list of areas where prevention spending should be increased. With the federal government showing little sign of expanding its spending, these groups are looking to the states. Out of the list of proposals, there are many that have appealed to state officials:

- **Public health education** on such subjects as nutrition, smoking, alcohol consumption, prenatal care, and periodic examinations.
- **Traditional public health measures** such as inoculation of children against diphtheria and care of patients with highly contagious diseases such as AIDS and tuberculosis.
- **Subsidy** of costs of diagnostic procedures used for prevention, such as mammography, by use of mandates in private health plans and other forms of public support for persons not on Medicaid.
- **Increased** efforts to deal with environmental health risks such as radon, pure drinking water, and workplace environmental standards.
- **Improved prenatal care**, particularly for low-income families.

These programs have not fared nearly as well in budget allocations as in rhetoric allocations. Traditional public health activities are one of the "other" programs that tend to be squeezed by across-the-board cuts and hiring freezes as state officials attempt to accommodate escalating Medicaid and corrections costs, provide increases for public schools, and avoid tax increases.

One reason for the difference between health-oriented rhetoric and reality-oriented budgeting is that prevention programs do not save money, in the sense of relieving costs in present or future budgets. Costs of care in Medicaid and charity hospitals cannot be reduced in a particular year's budget just because spending on prevention is increased.

It is doubtful that prevention saves state funds in the long run. Prolonging life is a valued objective, but not as a money-saving measure. Success in prolonging life puts more people into the higher age brackets where Medicaid pays for about half of all nursing home costs and for expensive procedures (e.g., prostrate surgery) used primarily by older persons.

Medicaid Costs Rising

If people want the kind of Medicaid program they say they do, then the only solution is for the legislature to come up with the money. — Arkansas' Medicaid Director on the FY 1993 shortfall.

Measuring Spending Increases: State general fund budgets have become poor measures of Medicaid cost escalation. Many states are treating provider tax revenues and the state and federal spending they finance as off-budget. Shifting costs, such as those of state institutions, from state to Medicaid funding often increases total costs, but reduces state general fund outlays. As a result, some states are incurring 10-30% increases in Medicaid costs while reporting that state spending for health care and/or Medicaid isn't rising much. Some states, notably **Illinois**, are borrowing money to pay Medicaid bills.

The best current measure of Medicaid's rapid growth is the 20-30% annual rate of increase in federal Medicaid spending. Because the federal matching ratio is unchanged, these outlays mean the states are convincing federal reviewers that state outlays are increasing at the same rate.

Outlays Could Exceed Appropriations This Year: All the election-year incentives argued for underestimating Medicaid costs in this year's enactment of FY 1993 budgets. Underestimating helps avoid the apparent necessity for pre-election tax increases or sharp spending cutbacks. It also avoids the perceived unpopular move of providing greater percentage increases for Medicaid than for public schools.

In the spirit of such underestimates, announcements of projected shortfalls should be rare before November. But they would be common when supplemental appropriation requests accompanying proposed FY 1994 budgets are released in December and January. In this context, two states publicly dealing with Medicaid deficits may be signs of what will come in other states.

Overruns In Arkansas: Allowing any program to spend at a rate that is not sustainable for a full fiscal year is more contrary to the budget culture of **Arkansas** than of most states. The state also has more serious enrollment escalation, with Medicaid rolls up 11% from a year ago.

Acting administratively, Arkansas has rolled back many of its discretionary expansions of eligibility and services including most optional services and eligibility for pregnant women and infants between 185% and 133% of the federal poverty level. A cut in physician reimbursement rates was announced, but quickly embroiled in litigation.

Overruns In Nebraska: Medicaid enrollment, which increased from under 100,000 in 1990 to over 120,000 this year, is also part of the problem in **Nebraska**. Another part is reimbursement rates. They have increased for nursing homes, reflecting new federal quality standards. They may increase for hospitals if the state settles litigation brought under the federal Boren Amendment (on reasonable cost reimbursement). Medicaid ran over its budget in FY 1992 by $7 million and was expected to overrun by $10 million this year, until a September announcement by the social services director suggested $20 million would be a better number. A special legislative session is expected to deal with the problem this fall.

Controlling Treatment Costs

> *Illinois Medicaid coverage is better than the insurance plans for both its own state workers and for employees in a typical private sector health-care program. There are no deductibles, no out-of-pocket expenses, and no limits on coverage. As an economist might say, Medicaid is a free good for enrollees.* —Mandeville (9/28).
>
> *Although this was an isolated incident, Chip Rowan of the AIDS Legal Project sees it as "a viable prospect for the future."* — Atlanta Constitution *(8/29)* describing an Alabama man with AIDS who said he stole a VCR to get back in jail so he could get the expensive drug AZT. The Constitution discusses potential prisoners in Georgia trying to get jailed to get medical care and countermeasures by law enforcement agencies to send them home.

While states have experienced considerable success in getting health consumers to pay Medicaid costs by provider taxes, there is little success in controlling costs. Everything looks uncontrollable to Medicaid administrators. Most enrollment (participation) is controlled by federal mandates and participation in cash assistance programs. How much service is consumed is largely set by recipients and their health care providers. The reimbursement rates are hard to control in any case and harder with litigation under the Boren Amendment and the need to enlist provider support for provider taxes. Claims of potential savings associated with using managed care and health maintenance organizations have become more modest as experience has increased.

Employers And The Federal Government Aren't Helping

While private employer health coverage and federal action may be the long-term salvation for states struggling to deal with health costs, the actions of the federal government and employers are aggravating current problems with no relief in sight.

Employers: Employers are trying to control their own costs. One way to do this is to avoid state mandates of coverage by use of self-insurance and simply by not providing coverage. Another is to litigate against the state plans that seek to cover hospital care for uninsured residents by large surcharges on paying customers. Litigation, contending the ERISA legislation prevents this, has put plans in **Massachusetts**, **New Jersey**, and other states in jeopardy. Yet another is for employers to force employees to pay a greater share of their costs by: co-payments, deductibles, exclusions of coverage. and ceilings on large payments. Each mechanism has the potential to force employees into Medicaid for expensive treatments, such as those associated with AIDS. These actions, which are common: (1) tend to increase costs left for Medicaid, (2) increase the pool of uninsured persons not eligible for Medicaid who would have to be covered by state universal health plans, and (3) increase the amounts of unreimbursed hospital costs.

Federal Government: Ross Perot's book, United We Stand, may or may not help achieve the author's political ambitions but suggests what could happen in federal policymaking. When Perot addresses health care, he does the same things as other candidates and state officials: (1) criticizes the cost of the current system, (2) endorses prevention and cost-containment, and (3) supports a national health policy (with unspecified basic benefits) achieved through "reaching a consensus," "encouraging problem solving by everyone involved," and "appropriate tax treatment."

Another portion of Perot's book combines many oft-considered mechanisms for balancing the federal budget. The suggestions are selections from budget option lists of the Congressional Budget Office and various expert recommendations, some of which could be taken seriously as early as 1993 regardless of who is elected to federal office. The key ones affecting state health care policy:

- Requiring Medicare recipients to fund 35% of their costs, up from 25% currently. States are mandated to "buy into" this coverage on behalf of cash assistance recipients, so states would pay part of the increase.
- End the tax exemption for employer-paid health insurance exceeding $335 a month for family coverage and $135 for individuals. Comprehensive plans already cost more than this, so employees (including state and local employees) would pay income tax on the excess. Private employers, and to some extent state and local governments, would find if both were taxed equally, many employee organizations would be more interested in employer payment of the excess as wages and salaries than as health insurance. Given the money, some individual employees would buy added employer coverage, but some wouldn't, further increasing health services left uncovered by insurance because of limits on health plan benefits.

The offsetting gain for states with income taxes that conformed to the federal policy would be the added income tax revenue.

- Raise the federal tax on tobacco. Higher resulting prices would discourage consumption, as advocates desire. But the declining consumption would cut revenues from existing state tobacco taxes, some of which have revenues earmarked for health programs, and discourage enactment of the many proposals for higher state taxes with earmarked revenues.
- Cap Medicaid spending growth. No Presidential candidate is advocating this precisely, but the numbers for it find their way into savings estimates. Perot counts $141 billion over five years from health care reform "to improve the quality and delivery of medical services through Medicare and Medicaid."
- Cut other federal health outlays. The Perot prescription is a 10% cut for what is called federal discretionary spending. Because hard-to-cut programs like IRS tax collection and federal law enforcement are in the 10% and easier-to-cut programs like space and rural electrification are separately counted upon for extra savings, an across-the-board cut might fall disproportionately on health activities. The health programs at risk include a variety of federal grants for state-administered programs and direct federal activities (e.g., with Indian tribes and migrant workers) where states would have heavy responsibilities for dealing with any resulting unmet health care needs.

The Outlook

New taxes on health care providers helped many states weather fiscal problems in 1991 and 1992 and appear to have additional potentials for nearly all states for dealing with rising health care costs in 1993. Given choices of raising general taxes and holding education increases to below-inflation levels, provider taxes are likely to be where much of the action in state money-raising occurs in 1993. With broader choices, state officials might not opt to raise health care prices by taxing health services, but are likely to work pragmatically with the choices they have. They don't have to feel good about the resulting health care, state, or federal policies. Many would probably agree with the concluding paragraph of "**Hemorrhage**" a Forbes (9/28) discussion of Medicaid:

> *The states cannot afford to sustain the Medicaid largesse on their own. For example, this year, even after using some tricks to pass costs back to the feds, Florida had to funnel two-thirds of all new state general revenues to Medicaid, crowding out spending for other needs. Faced with the same crowding out, Colorado's legislature voted this year to drop out of Medicaid. The governor vetoed the bill, but the message was clear. There has to be a better way to provide health care to the poor.*

PERSPECTIVES ON STATE HEALTH FINANCING

Differing Assessments Of State Action

The **Reports** assessment of prospects for state financing of health care for the poor and uninsured boils down to an unappealing bottom line. While states may cover some escalating costs of current coverage with general funds, they are unlikely to finance expansions of coverage under Medicaid or other programs unless that expansion is paid for by the federal government or levies on other consumers of health care.

Many state officials are presenting initiatives in more appealing terms than these. Associations of state officials, particular the National Governors' Association, have published many materials making the case that states are implementing major innovations in health care finance. State officials seeking reelection are touting what they have done. Candidates for state office are talking enthusiastically about what they will do. Some journalists have written favorably and optimistically about the significance of state action.

Differing Assessments Of What Has Been Done

One cause of the differing assessments just reflects a tendency of incumbents' public statements and their associations' publications to take a more sanguine view of incumbents' accomplishments than the view taken by an independent publication. Other causes are more substantive. The differing views appear in the areas summarized below.

Demonstration And Pilot Programs: Many states are undertaking health care delivery and financing projects for selected populations representing a fraction of the clients and cost of applying the same policies statewide. "Seed money" for these programs has come from private funds, the federal government, and state general funds. One view is that these are the early steps on the road to more universal programs. Another is that they are the response to strong pressures for action conflicting with compelling reasons, mostly fiscal but also programmatic, for not taking it.

Time will tell. It has told in the case of welfare reform demonstration programs involving job training, where demonstrations have become a federal program for which many states are not willing to provide matching funds. The outcome is uncertain for education reform demonstrations and pilot programs. Some have been dropped in competition for funds with unrestricted school aid but some have shifted to statewide funding and/or mandates. In the case of demonstrations which deliver improved care, but appear to raise Medicaid costs, the federal attitude toward waivers will also be significant.

Plans To Make Plans: Another source of differing perspectives involves what significance to attach to legislation of the type passed in **Florida**, **Minnesota**, and **Vermont**. To differing degrees, these laws *enact a plan*, designate an agency to study and report the specifics of the plan, and require further legislative action before something major (like a new tax on employers who don't comply with mandated coverage for employees) happens. One view is that such laws differ little from oft-tried laws that *enact a policy statement*, designate an agency or commission to study and report how to achieve the policy, and require further legislative action before something major happens. Another view is that the enacted plans should be treated as tantamount to final legislation, or at least more significant than mere studies, Blue Ribbon commissions, and task forces.

Many observers treat federal rejection of the **Oregon** plan as a temporary setback soon to be remedied. Others have doubts over federal approval of a revised plan and whether Oregon legislators, now preoccupied with an untenable fiscal situation, will implement the plan even if it is approved in Washington.

Affordable Coverage: Many states have adopted plans to encourage more employers, particularly small employers, to provide employee health coverage and to enhance individual coverage for those with special health problems by reducing prices and discouraging denials of coverage. No one doubts that these work to the extent funded by general taxpayers through appropriations and tax credits. The questions are over how much money is needed and whether state officials will provide it.

The other elements of the plans are simple ideas: (1) making plans cheaper by exempting them from past state mandates of coverage and (2) making coverage cheaper for some customers by making it more expensive for others, as is now done in assigned risk plans in auto insurance and Workers' Compensation. These actions should achieve the objective of lower costs, but at a price. The results may be good or bad, but won't be dramatic.

Federal Action: Optimists about state actions that improve health care financing hope for federal approval of ERISA exemptions and considerable new flexibility in Medicaid. Some Medicaid plans assume federal consent to eliminating "freedom of choice" among providers, to denying some services now covered, and to covering costs not now covered. Pessimists fear federal inaction on the ERISA exemptions (opposed by business and much of organized labor). They also fear that federal policy will either reject all waivers that might increase federal cost or allow states flexibility only in return for Medicaid spending caps.

Pessimists also worry that it will not take federal budget cutters long to argue that federally paid costs (e.g., purchased care for military personnel and dependents, Medicare, Medicaid, and other programs) should be exempt from provider taxes.

MISCELLANY

Fiscal Priorities And Performance

The latest Department of Commerce estimates of state and local finances (Survey Of Current Business, August) suggest that priorities reflected in performance are the opposite of public preferences as reflected in most polls. In taxes, practice has preferred property taxes. The biggest spending gain is in transfer payments, such as welfare and Medicaid.

Percentage Increases In State and Local Spending And Revenues
Periods Ending In The Second Quarter Of 1992 (National Income Accounts Basis)

Category	Last Year	Last Quarter
Property Taxes	7.6%	1.9%
Sales Taxes	6.5	.5
Income Taxes	5.8	1.0
Transfer Payment (welfare) Spending	18.7	3.9
Employee Compensation	4.4	1.6
Purchases (e.g., supplies, infrastructure)	1.2	-0.6

Layoffs Of State Employees

While major layoffs have been threatened in many states over the past two years, few have occurred. The major exception is **New Jersey** where some 2,000 workers were slated to be axed in October as a result of tight fiscal circumstances and the legislature's decision (overriding a veto) to roll back the 1990 sales tax increase.

The legislature directed that layoffs be confined to jobs paying more than $50,000, but the Florio Administration claims this is impossible. Employee organizations have fought the layoffs in court, in part on the grounds that the legislative language in appropriations bills usurps executive powers. Whether appropriations alone restrain employment or layoffs are concentrated on high-wage workers, much of the impact will ultimately fall on low-wage workers. New Jersey has extensive "bumping" rights, so the personnel director estimates each layoff will affect as many as four or five workers as laid off workers bump lesser paid workers out of their jobs and the bumped workers exercise their bumping rights. Because no one knows how many displaced workers will opt for retirement or seek other jobs, no one knows how many workers will finally be laid off.

There are also significant layoffs associated with FY 1993 budgets in **California** and **Illinois**, with cutbacks of enacted appropriations in **Alabama**, and probably with both in some other states. Because of bumping and lags in decisionmaking as administrators consider how to take cuts, exactly what will happen in these states isn't yet known.

Pension Funding

Revisions in actuarial assumptions and funding schedules for state-administered pension plans for state and local employees played a major role in FY 1993 budget-balancing. For example, **New Jersey** produced $700 million of state fiscal relief and reduced financial pressures on school districts making smaller state aid increases more tenable.

Two common changes are revaluing security holdings from book to market value and altering the assumed rate of return on investment. *These assumptions are interactive.* It may be appropriate to assume a return of 8.5% and may be appropriate to use book values that are, say, 80% of market value. The net effect is the same as assuming 6.8% and using market value. More risk of inaccuracy occurs when state and local contribution requirements are lowered by switching to market values *and* increasing rate of return assumptions.

Revisions in actuarial assumptions have put some states at substantial risk of not meeting their funding targets. Particularly in the plans heavily invested in short term obligations, the lower interest rates being experienced by individual investors in certificates of deposit and U.S. Treasury bills and notes have already reduced investment earnings. For systems that value assets at market prices, stable stock prices have meant reporting little or no return from appreciation. Private pension managers face the same problem as public plan managers. As the Wall Street Journal recently (10/5) headlined, "Pension Fund Managers Face Moment Of Truth As Interest Rates Plunge And Equities Stagnate." If long term interest rates rise, as sooner or later they could be expected to do, the market values of long-term bonds (and perhaps stocks) held by pension funds would be expected to drop.

Workers' Compensation On Front Burners

Workers' Compensation issues are drawing attention in many states. In **Pennsylvania**, the governor called the legislature into an October special session to attempt to agree on a workers' compensation reform package. Without action, one forecast is that rates would rise by 40-55%. In **California**, Governor Wilson is saying the state is short 1,250,000 jobs (750,000 actually lost, the rest from growth that should have occurred but didn't). Blaming recession for about half the loss and state policy for the rest, he also called an October special session to deal with WC reform.

The issues are highly partisan in both states. For example, Governor Wilson (R) told a business audience that if lawmakers won't change the WC law in October, "we must change the lawmakers." A leading House Democrat on WC issues called the governor's call for the special session "full of shrill, Democrat-bashing, language." and "hysterical, overblown, deceptive rhetoric."

In **Maine,** WC, not fiscal issues, delayed the budget last year. Now, legislators are considering reforms suggested by the Blue Ribbon Commission whose appointment resolved last year's problem. In **Missouri**, the gubernatorial candidates are running ads saying their opponents have improperly benefited from WC — one for large campaign contributions from lawyers that he hired as attorney general to defend the state's second injury fund against claims and the other for large fees for representing WC claimants.

TECHNICAL NOTES

State Finances: Classifying states' fiscal positions obviously required educated guesswork, but the framework for it was rigorous. *Current service spending* was defined as continuing current policies with adjustments for inflation and workload changes (e.g., enrollment, prison populations). The definition excludes self-imposed spending increases, such as scheduled escalation in school aid spending beyond inflation and enrollment-driven changes and spending to comply with consent decrees. The definition includes pay changes matching inflation, which many states don't include. For *revenues from current taxes*, scheduled expirations of temporary taxes and scheduled tax reductions were ignored.

The bond rating changes come from Sarah Ritchie's Credit Rating Changes: An Indicator of State Fiscal Stress (Center for the Study of the States, Rockefeller Institute of Government, 411 State St., Albany, NY 12203). Ritchie finds a close correlation between ratings and **Reports**' Index of State Economic Momentum. As of late July, both Moody's top rating (Aaa) and S&P's (AAA) were held by only six states: Maryland, Missouri, the Carolinas, Utah, and Virginia. Both agencies agree that the bottom ranked states are Louisiana, Massachusetts, and New York, but disagree on the order and the letter rankings.

For more pessimism on the states' fiscal outlook ("fundamental budget problems remain"), see Ronald Snell (NCSL), "The Malaise Lingers," State Legislatures (October).

Health Finance: The Kentucky poll was reported in the Louisville Courier-Journal (9/27). For a readable presentation of the view that impressive progress is occurring see Penelope Lemov's "Health Care Reform: The States Get Serious," Governing (Oct.).

Workers' Compensation: For a national summary of the issues, see "The Agony Of Workers' Comp.," State Government News (Oct.). The Ford Foundation's recent awards for innovation (Governing, Oct.) include one to Oregon for managing WC, though not everyone would agree with some of the policies (e.g., benefit cuts, using a government-run fund rather than competing private insurance companies).

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The states continue to scramble for jobs, as illustrated by new incentives in Ohio and proposals in Massachusetts. But decisions in Illinois and Louisiana suggest limits on what states will spend.

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Many state officials are finding that nearly all of their spending is "uncontrollable." Proponents of the remaining "controllable" and thus vulnerable programs are wondering how to become uncontrollable.

- Protected Programs p. 8

New statistics show the poverty rate ranging from under 6% in Connecticut to nearly 24% in Mississippi.

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Candidates are counting opponents' tax increases, but most of the growth in tax revenues comes automatically. New economic forecasts and recent tax collections suggest automatic growth may not be enough.

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October 1992 (Second Of Two October Issues)

COMPETING FOR JOBS

The competition for economic development remains intense even though states don't have much money to spend to seek new jobs and the private sector isn't creating many jobs for states to chase.

New Development Incentives In Massachusetts?

This fall Governor Weld is actively campaigning for his development strategy. The effort isn't noteworthy for the proposals, which reflect policies under consideration in some states and in effect in others. More noteworthy is who is proposing them, at what cost, and with what rationale. Weld gets considerable national attention as a dynamic, personable Republican governor who has shown electability in one of the nation's most Democratically inclined states and who takes credit for turning around the finances of a deficit-ridden government. These characteristics make him a national figure and his view on state economic strategies more significant than the average governor's.

Part of the program is pure tax policy. The proposals, lowering taxes on capital gains and increasing business tax credits, would be evenhandedly applied in the name of improving the state's economic climate. The current program reflects a partial shift because his earlier proposal to reduce the personal income tax rate has been dropped in favor of incentives more targeted to investors and business. The proposals are drawing opposition from those who don't believe that the state's budget is in good enough shape to afford the revenue loss and those who believe that if money is available, it should be used for spending rather than tax cuts. The governor's plan also includes acceleration of infrastructure investment and a version of enterprise zones, with additional tax benefits to companies expanding jobs in the zones.

The program involves a state "industrial policy," providing assistance to specific firms. The amounts involved are relatively small. The proposals are for the state to begin:

- An **Emergency Technology Fund** that would use $30 million for corporate manufacturing and R&D facilities by partial loan guarantees, subordinated debt financing, and other techniques putting state money at risk.
- A **Small Business Capital Access Program** (modeled on an existing program in Michigan) that would provide $10 million to banks to encourage them to make loans for small business that they wouldn't otherwise make.
- An **Export Finance Program** using $10 million to provide loan guarantees to Massachusetts companies, particularly smaller ones.

The Senate President (D) argues that these programs are a "crystal clear" violation of a state constitutional provision which prohibits using state money to assist privately owned companies. Similar programs have encountered similar obstacles in other states, with some state constitutions modified to make the programs possible. The governor acknowledges that his plan "does make some conservatives nervous," His rationale depends upon the concept of market failure. That is, that the free market should generally be relied upon for capital financing of specific firms with governments not picking particular firms, but government intervention may be appropriate if the market is failing for some reason. Many state officials, particularly in New England, believe that the markets overlook profitable opportunities for certain forms of business investment, such as long-term capital investments in small and medium-sized firms.

While some business leaders and state officials have reservations about what they call "picking winners," the concept seems likely to be accepted in Massachusetts. Some leading Democrats, including the speaker, have proposals of their own. A key business group, Associated Industries of Massachusetts, has endorsed the philosophy of these bills and the governor's. The group's newsletter (9/25) comments:

> *Although our recovery depends in large measure upon national economic trends, state government action can be an important catalyst for revitalization. Competing states know this. In the Northeast, New York provided $46 million in loan and loan guarantees between April and July; New Jersey has just announced a $25 million venture capital fund to supplement its existing guarantee program; and the massive $1 billion "Connecticut Works" effort has already saved or created many jobs in our hard-pressed neighboring state.*

The governor is also proposing to merge ten development-oriented agencies, many quasi-public bond issuing agencies. Reflecting many of the development ideas of the 1980s, the Massachusetts list is longer than most:

Bay State Skills Corporation
Industrial Services Program
Massachusetts Community Development Finance Corporation
Massachusetts Community Economic Development Assistance Corporation
Massachusetts Education Financing Authority
Massachusetts Government Land Bank
Massachusetts Health and Educational Facilities Authority
Massachusetts Industrial Finance Agency
Massachusetts Microelectronics Center
Massachusetts Technology Development Corporation

Fastest Growing Private Companies

For the past 11 years, Inc. magazine has prepared a list of 500 American companies that are both relatively small and exhibiting rapid growth. To provide comparability among states, **Reports** counted the winning companies in relation to population. The results are shown on the table.

Number Of Inc. Fast-Growing Companies Per Million Residents, 1992

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Idaho	4.81	18	Wisconsin	2.22	34	Illinois	1.13
2	Virginia	4.77	19	Oklahoma	2.20	35	West Virginia	1.11
3	Colorado	4.74	20	Washington	2.19	36	Kentucky	1.08
4	Utah	4.52	21	Wyoming	2.17	37	North Carolina	1.04
5	Arizona	4.00	22	Indiana	2.14	38	Rhode Island	1.00
6	Vermont	3.53	23	Oregon	2.05	39	Alabama	0.98
7	Massachusetts	3.50	24	Minnesota	2.03	40	Maine	0.81
8	New Mexico	3.23		**United States**	**1.98**	41	Nevada	0.78
9	Delaware	2.94	25	New Jersey	1.80	42	Mississippi	0.77
10	Georgia	2.87	26	Tennessee	1.62	43	Iowa	0.72
11	New Hampshire	2.71	27	Kansas	1.60	44	Louisiana	0.71
12	California	2.57	28	Missouri	1.55	45	South Carolina	0.56
13	Nebraska	2.51	29	New York	1.44	46	Alaska	0
14	Maryland	2.47	30	South Dakota	1.42	47	Arkansas	0
15	Connecticut	2.43	31	Ohio	1.19	48	Hawaii	0
16	Texas	2.36	32	Michigan	1.17	49	Montana	0
17	Florida	2.26	33	Pennsylvania	1.17	50	North Dakota	0

As might be expected, there is a reasonably close relationship between successful companies and a state's Index of State Economic Momentum (Issue 18). This reflects both the tendency of fast-growing companies selling in international markets to contribute to a state's growth and the contribution a fast-growing environment makes to a company's growth. In this context, it is noteworthy that some states now with stagnant economies (e.g., **California**, **Connecticut**, and **Massachusetts**) placed in the top third.

States And The International Economy

Speakers on economic topics are fond of reminding their audiences that the economy is constantly becoming more globalized. This assessment, if measured by the percentage of domestic demand satisfied by imports or the percentage of domestic jobs associated with exports and international tourism, is clearly true. The question is how states should react

The general reaction in state policy has been to adjust current programs to recognize the importance of international markets. In this spirit, industrial development programs, in some states more than others, consider foreign as well as domestic firms as their targets. Some have impressive results, such as the BMW plant being built in **South Carolina**, to show for their efforts. Programs to encourage growth of in-state businesses now have export promotion components. Tourism programs of many states seek to reach international as well as domestic travelers.

Beyond these, state actions show a mixed pattern. States are still establishing offices abroad to promote trade and investment, but many offices established in the past are being shut down. By one count, about a dozen states have closed or reduced their offices in Japan, including closures of Tokyo offices by **Pennsylvania**, **Texas**, and five smaller states. States are developing varied mechanisms to consider international developments in a state policy context, such as the establishment of a special position of assistant director for international relations in the **Kentucky** Legislative Research Commission staff. There are several new publications designed to help state officials decide how to respond to globalization (see Technical Notes).

Connecticut Bets On Sports

Connecticut is seeking to deal with its continuing economic woes with the massive "Connecticut Works" effort for business assistance. The state has made $150 million worth of loans and loan guarantees in the last 18 months, including going further in involvement with sports teams (as distinct from stadiums) than other states. The state is making what would have to be called a high risk loan to the Hartford-based Whalers, the hockey team that is the only major professional team based in the state. A Connecticut agency is also guaranteeing $10 million of loans to the team. It has been losing money due to some combination of hard times in its attendance area and poor performance on the ice. The Hartford Civic Center, where the team plays home games, is increasingly becoming the commercial anchor of downtown Hartford, which recently lost its last major department store.

State Development Wars

Kentucky v. Ohio: In January, Ohio firms will start receiving an estimated $30 million in tax reductions from a special industrial development package passed with few dissenting votes at a recent special session of the legislature. The legislation exempts purchase of equipment for research and development from the sales tax and provides tax credits for expanded employment associated with job expansion. Citing competition with other states, Ohio's governor is encouraging the legislature to pass a Workers' Compensation reform bill by the end of the year.

In support of his proposals, Governor Voinovich told legislators that over the past ten years Kentucky manufacturing employment has grown 15% while Ohio's declined by 4%. He cited lower taxes and Workers' Compensation rates as two Kentucky advantages. The incentive bill's sponsor said that three firms had recently moved across the river from the Cincinnati area to take advantage of the Kentucky Job Development Act. It offers a ten-year reprieve from state income taxes for companies that: (1) have three-fourths of their sales outside of Kentucky, (2) add 25 or more jobs, and (3) relocate to Kentucky.

Ohio v. Illinois: While much of the impetus for Ohio's action came from competition with Kentucky, the legislation got a strong boost from success in competing with Illinois. Ohio won the competition for a Spiegel Inc. distribution center with 1,500 jobs over several states, including Illinois where the firm's distribution activity is now located. Ohio officials told Spiegel executives about the pending legislation and the likelihood that it would pass. In supporting the bill in late September, the Ohio House speaker told members that Spiegel wanted passage by early October.

North Carolina v. East Coast Port States: North Carolina has new legislation to encourage use of the ocean ports at Wilmington and Morehead City. A tax credit is based on current use of the ports compared with use during a three year base period.

New Jersey v. New York For Office Locations: First Chicago Trust Company recently signed a lease to occupy Jersey City office space, moving about 1,000 employees from Manhattan. The decision was encouraged by a New Jersey decision to pay about $6 million ($6,000 per employee) to complete the office space to the firm's specifications and to furnish and equip it. The money to pay these costs comes from the state's new $200+ million war chest called the Economic Recovery Fund. The New York Times (10/7) called the action "an escalation in the office war it {New Jersey} has waged with New York City."

Besides the special concession on furnishing, First Chicago will get the substantial state concessions offered to firms operating in Urban Enterprise Zones. They include:

- A break of about 50% on real estate taxes,
- A discount on electric rates of 7-10% for seven years, augmented by a reduction of 25% in the first year, and
- A 15-year exemption from sales taxes on essentially all the company's purchases.

Besides special concessions, the New Jersey location had other advantages. While New Jersey and New York both have state personal income taxes, New York City has a graduated local tax which has no counterpart in New Jersey. Also, the building owners in New Jersey clearly made price concessions to find a major tenant for their unoccupied space.

The tax angle was blamed for New York City's economic woes by a city council staff member in an OpEd in the Wall Street Journal (10/6). Stephen Kagann calculates that since April 1989 the city has lost 360,000 jobs, a fifth of the national total. The city's private sector job loss is 15%, if private jobs supported by public health care and social service dollars are excluded.

Second Thoughts On Development Incentives

One of the constitutional amendments adopted by the **Louisiana** legislature as it recently finished its session as a constitutional convention is designed to end the practice of automatically granting local tax abatements for corporate facilities financed with tax-exempt bonds. Repeal of **Nebraska**'s corporate tax incentives, adopted in 1987, may not occur, but there is concern among legislators. A new study finds that the incentives for job development have cost considerably more than expected when the legislation passed. A recent Business Week (9/21) article ("States Now Want A Money-Back Guarantee") concludes, "Even in hotly contested deals, states are showing more savvy." It cites increasing use of *clawbacks* (provisions requiring return of subsidies if plants don't remain open), cost-benefit analysis of development incentives, and provisions in development deals tying state incentives to actual company performance such as the number of jobs created.

Bearing an economic development moniker hasn't been a guarantee that state programs won't be cut in austere periods. Some states have cut funding of their development agencies substantially, including eliminating some of their foreign offices and freezing or cutting activities like technical assistance to industry. In **Illinois**, where economic and community development activities are combined in a single agency, the FY 1993 general fund appropriation of $27.6 million is down from $93 million in FY 1992. Agency officials are talking about working with local development groups so that the state becomes a "wholesaler" of development activities. Rather than complaining loudly about the reduced state role, the president of the Chicagoland Chamber of Commerce told the Chicago Tribune (7/7) that the development appeared to be a natural one:

> *The economic times tend to drive these things. In the 1980s there was a lot of prosperity and people were prepared to spend. On Diamond-Star (the Diamond-Star Motors auto plant at Normal) they spent somewhere around $80,000 per job between the tax breaks and tax increment financing and enterprise zones. But in recession, government has to rethink, and you have to go back to the basic service you're supposed to provide, like public safety, health, and education.*

Wisconsin v. Illinois: Within two months of the Illinois action, the Milwaukee Journal (8/23) reported under the headline "Aid Cuts In Illinois Give State An Opening:"

> *The competition for business development between Wisconsin and Illinois heats up today as Wisconsin takes advantage of budget cuts in Illinois' business aid programs to launch a campaign to attract Chicago-area businesses to relocate or expand north of the border...*
>
> *Robert Trunzo, secretary of the {Wisconsin} Development Department said: "We think Illinois' situation presents an exciting marketing opportunity for us."*

PROTECTED PROGRAMS

There is increasing recognition that being an unprotected program in tight budget times results in budget cuts when practically all other programs are protected against the budget ax. This was recognized in the **Louisiana** constitutional convention and at an October rally at the state capitol when college students evidenced their support for the resulting amendment. It gives the legislature more power to cut programs, including school aid which enjoys constitutional protection in Louisiana.

The degrees of protection are quite different among different programs and perceived differently in various states based on in-state factors such as state court decisions and state constitutional provisions.

- **Binding Contracts** protect debt service appropriations, long-term lease payments in some states, and sometimes multi-year agreements such as employees' pay. Pension *payments to beneficiaries* and some other commitments (e.g., retiree health care) are considered contractual in some states, but state *contributions to pension plans* aren't.

- **Federal Constitutional Law** puts a floor under some state activities often including the conditions in state correctional and mental health institutions. Some programs are effectively mandated. For example, states can avoid paying for criminal defense lawyer costs for poor people only by refraining from prosecuting poor people.

- **Federal Statutes** constrain AFDC and Medicaid in many ways. For example, benefits cannot be cut without following certain procedural rules; states must provide a list of basic Medicaid services to have a Medicaid program; states cannot provide services to some without providing them to others, etc.

State actions under the control of the current legislature and governor are also constrained by state constitutions and interpretations of constitutional mandates by state supreme courts. Some of the most significant constraints are: (1) school equalization cases which don't technically affect total spending but which always do in practice, (2) criminal and inmate rights found in state constitutions by state courts though not found in similar or identical language in the federal constitution by federal courts, and (3) interpretations of constitutions and statutes appearing to create rights to have certain state services delivered.

When these constraints are summed, they significantly restrict the flexibility of state officials in dealing with new budgets. A common calculation is to add up all of these commitments or mandated programs as a percentage of the state's budget. The governors of **California** and **Texas** are fond of this calculation, using numbers over 75%. When revenue growth is slow, another approach is to calculate the percentage of growth required to cover unavoidable spending growth. This number can be over 100% under some circumstances.

Another way to use this information is to assess the situation of any program not protected by judicial decree, federal or state constitutional requirements, binding contracts, and federal mandates. In speeches before higher education groups, **Reports** editor Hal Hovey has been shocking audiences with the line that the path to survival in tight state budget periods is to have one or more of these. He suggests that higher education is about the only activity that isn't protected by one or more of them, thereby explaining why higher education has fared so badly in state budget competition.

The problems in defending higher education appropriations in current state fiscal situations goes beyond legal commitments to other programs. An example is **Kentucky** where university students rallied at the capitol in mid-October against possible mid-year budget cuts. Several years ago, the state raised taxes primarily to fund an extensive school reform and school finance equalization effort. The resulting school plan was adopted as a multi-year effort with constantly escalating costs. As recession depressed revenues and as other spending (particularly Medicaid and corrections) experienced substantial increases, higher education has been squeezed. Before any mid-year adjustments, the state higher education appropriation is about 2% lower than for FY 1992. While made in response to a court equalization decision, the legislature could back off elementary and secondary funding increases, but would then simply increase the criticism that much of the tax increase has been diverted from school quality improvement.

POVERTY

The Census Bureau recently released new data on median incomes and the percentage of persons in poverty in each state.

Because of the small samples involved, particularly for less populous states, the Bureau cautions: "Data users are advised strongly against using these estimates to rank states because different samples easily could lead to different median income and poverty rate estimates and rankings." Notwithstanding this warning, rankings from official data with caveats are clearly more useful than mere speculation, so the rankings are presented in the table below.

The caveats are quantified as "standard errors" in the Census report. They suggest that for the average-sized state of five million, the percentages shown could plausibly vary by about 0.6%, so Indiana's rate of 14.1% could be 14.7 or 13.5 and smaller states could vary more. This suggests caution in attaching much significance to narrow differences among nearly even states. Acknowledging this caveat, it is clear from the data that poverty rates do show significant differences among states.

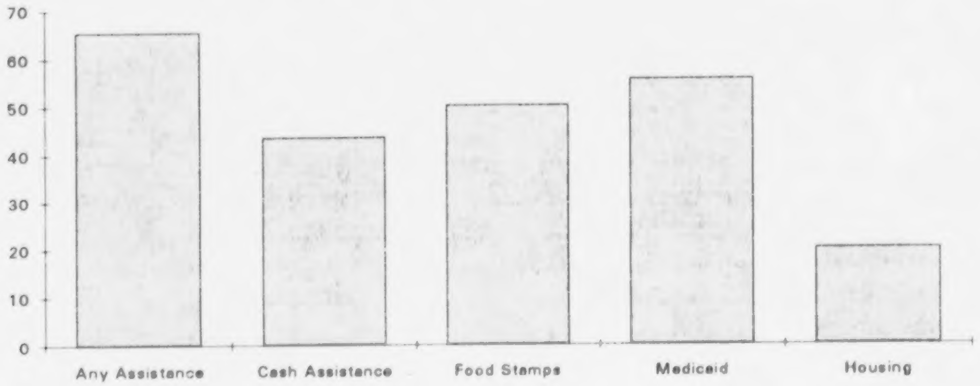
Percentage Of Persons In Poverty, 1989-1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Connecticut	5.8%	18	Nebraska	10.9%	34	Indiana	14.1%
2	New Hampshire	7.1	19	Kansas	11.1	35	New York	14.1
3	Delaware	8.1	20	Alaska	11.2	36	Arizona	14.2
4	Rhode Island	8.2	21	Oregon	11.3	37	California	14.2
5	New Jersey	9.0	22	Ohio	11.8	38	Montana	15.8
6	Wisconsin	9.2	23	Minnesota	12.0	39	Oklahoma	15.8
7	Maryland	9.3	24	Colorado	12.1	40	Georgia	16.0
8	Washington	9.3	25	Maine	12.5	41	South Carolina	16.5
9	Utah	9.8	26	North Carolina	13.2	42	Texas	16.8
10	Hawaii	10.0	27	Illinois	13.3	43	Tennessee	16.9
11	Iowa	10.1		**United States**	**13.5**	44	West Virginia	17.2
12	Massachusetts	10.2	28	North Dakota	13.5	45	Kentucky	17.4
13	Vermont	10.5	29	South Dakota	13.5	46	Arkansas	18.4
14	Virginia	10.6	30	Missouri	13.6	47	Alabama	19.0
15	Wyoming	10.6	31	Idaho	13.7	48	New Mexico	20.9
16	Nevada	10.7	32	Michigan	13.9	49	Louisiana	22.0
17	Pennsylvania	10.8	33	Florida	14.1	50	Mississippi	23.8

The states of the Old Confederacy have had the highest poverty rates since statistics began to be kept. High poverty rates are also found in states that have had substantial in-migration from Mexico and the Caribbean area. The key to having low poverty rates is to have the suburbs from a major metropolitan area, like Boston or New York, while having the central city of that area located in another state. In comparing states, it should be remembered that the standard of poverty-level income is uniform nationally and relates only to income, not assets. A significant percentage of the rural poor are homeowners, while the urban poor generally rent. Some living costs are also lower in rural areas.

The official poverty figures don't reflect assistance provided to the poor through government means-tested programs. That assistance, excluding school lunches and certain other programs, reaches 65% of people in poverty with Food Stamps, cash assistance (welfare), Medicaid, and/or subsidized housing. The chart shows the percentage participating in each program. Cash assistance alone provides enough money so that 57.3% of persons in households where it is received are lifted above the poverty level by it.

Percentage Of Poor Receiving
Means-Tested Assistance, 1991



TAX INCREASES AND AUTOMATIC REVENUE GROWTH

Counting Tax Increases

The Presidential campaign has produced rival counts of how many times Governor Clinton and President Bush have raised taxes. The debate has shown that the numbers are tricky. For example, to get a large number for Bush one needs to count many different changes incorporated in one bill. To get 128 for Clinton (listed in the New York Times, 9/23, by Bush's campaign manager) it is necessary to include fees and some relatively small items like the 1991 decision to levy a fee of $1 per head on pigs sold at auctions. Applying a similar standard to the President and including tariffs produces a total of 178 increases (listed in the Times, 9/29).

Measuring Tax Burden Changes

A larger problem is that the burden of taxes is primarily set by the interaction of existing taxes and a state's economy, not by the changes in rates and tax base that count as tax cuts and increases. For example, large sums result from differences between states with graduated income taxes that index them for inflation, as **California** does, and states that don't, like **Minnesota**. There is much more natural growth in a tax system using a base of a graduated personal income tax, no sales tax, and property taxes on rapidly rising valuation, like **Oregon**, than one without an income tax and with heavy reliance on declining production of oil and gas, like **Texas**. An extreme illustration is the contrast between gasoline taxes and personal income taxes.

With unchanged rates, or even small increases, the gasoline tax burdens in relation to personal income will tend to drop as cars improve their gas mileage and as personal income rises with inflation but per gallon gasoline taxes don't. Conversely, with unchanged rates or even small cuts, a personal income tax with fixed (unindexed) brackets and personal exemptions and deductions will take an increasing share of personal income.

So looking at increases in rates alone won't work. What does work is looking at all state and local taxes together and relating their revenue to total personal income. Steven Gold recently did this calculation to compare levels in FY 1979 to those in FY 1990. The results appear in the table.

Percentage Change State And Local Tax Burdens, FY 1979-FY 1990

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Massachusetts	-22.8%	18	Wisconsin	-2.2%	34	Hawaii	3.6%
2	Delaware	-10.0	19	Michigan	-2.1	35	New Mexico	3.6
3	New Hampshire	-9.7	20	Alabama	-1.6	36	Oregon	4.5
4	Rhode Island	-9.4	21	Kentucky	-1.3	37	Florida	4.6
5	Alaska	-7.9	22	Wyoming	-1.3	38	Arkansas	4.7
6	New Jersey	-7.0	23	Virginia	-1.1	39	West Virginia	4.7
7	Colorado	-6.1	24	Missouri	-0.4	40	Idaho	4.8
8	Pennsylvania	-5.9	25	Kansas	-0.2	41	North Carolina	4.8
9	Vermont	-5.9	26	Louisiana	0.1	42	Oklahoma	6.1
10	Maryland	-5.8	27	New York	0.3	43	Georgia	6.4
11	South Dakota	-5.0		**United States**	**0.7**	44	South Carolina	6.9
12	Arizona	-4.6	28	Illinois	1.8	45	Washington	7.7
13	Tennessee	-3.7	29	Maine	2.0	46	Iowa	7.8
14	Minnesota	-3.5	30	Montana	2.2	47	Indiana	8.0
15	Mississippi	-3.5	31	Connecticut	2.4	48	North Dakota	10.6
16	Nevada	-3.4	32	California	2.6	49	Texas	13.6
17	Nebraska	-2.8	33	Utah	2.7	50	Ohio	15.8

The differences among most states aren't dramatic, nor is the minuscule change in the national average. There appears to be no common explanation for the states shown as having raised tax burdens the most. The states that reduced burdens — defined as taxes as a percent of personal income — generally did so by extraordinary gains in personal income rather than by tax reduction.

Recent Revenue Increases, Personal Income Taxes

The distinctions between legislated and non-legislated increases, as well as difficulties in estimating revenue quarter-by-quarter are illustrated by the table. It shows the percentage increase in state personal income tax revenues in the second quarter of this year compared to the second quarter of last year, according to statistics compiled by the Center for the Study of the States.

Percentage Change In State Personal Income Tax Revenue, Second Quarter 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arizona	-22.6%	15	Georgia	2.2%	28	Kansas	7.1%
2	North Dakota	-10.4		**U.S. w/o change*** **	**2.6**	29	West Virginia	7.2
3	Kentucky	-8.1	16	Alabama	2.9	30	Montana	7.4
4	Michigan	-5.7	17	Ohio	3.2	31	New York	8.5
5	Oklahoma	-5.1	18	Utah	3.8	32	California*	9.0
6	Indiana	-4.9	19	Oregon	4.9		**United States**	9.2
7	Vermont*	-3.2	20	Iowa	5.0	33	South Carolina	9.2
8	Louisiana	-2.0	21	Mississippi	5.0	34	Arkansas	10.9
9	Maryland	-1.5	22	Minnesota*	5.3	35	North Carolina*	12.9
10	Massachusetts**	0.0	23	Maine*	5.6	36	Hawaii	16.0
11	Virginia	1.0	24	Delaware	5.7	37	New Mexico	22.5
12	Illinois	1.2	25	Nebraska	6.1	38	New Jersey*	22.9
13	Idaho	1.3	26	Wisconsin	6.7	39	Rhode Island*	39.9
14	Missouri	1.3	27	Colorado	6.8	40	Pennsylvania*	45.8

* Reflects legislated tax increase. ** Reflects legislated tax cut.

*** Change in revenues excluding increased rates and tax base.

If state personal income taxes tracked growth in personal income, they would have increased by about 4.6%. However, much of the personal income growth during the period covered was in transfer payments like welfare and Social Security that aren't taxed, so wage and salary growth of 3.4% might be a better benchmark. But most state income tax revenues grow faster than personal income because of graduated rates and the impact of fixed dollar exemptions and deductions. So a plausible range for natural personal income tax growth would be bounded by 3% or so on the low side and 9% on the high side. The increase in income tax revenues from withholding, 7.6% from the 30 states from which Gold had data, is well within this range.

Many of the state results shown in the table fall outside this range. Several factors cause the deviation. First, some states significantly changed tax rates and/or tax bases as indicated (* and **) on the table. Second, many states collected more tax on CY 1991 income from withholding and estimated payments than taxpayers owed, particularly taxpayers unemployed for part of the year. Those taxpayers got refunds, many during the second quarter, creating negative tax yields and offsetting growth from withholding. Third, many states have tinkered with due dates for taxes and timing of refunds either this spring or last spring, distorting the year-to-year comparisons. Fourth, quarter-by-quarter comparisons are inherently difficult because slight differences in timing of payments and processing by state agencies can cause massive changes in the percentage increase figures.

Recent Revenue Increases, All State Taxes

The table shows the Center's compilation of quarter-over-quarter increases in total revenues. This pattern is much less erratic than income taxes shown in the table above. Most of the double-digit increases are the result of tax increases (*) or special factors such as the addition of revenues in Florida that previously went to a special infrastructure fund. The decrease in Arizona is partly explained by 1991 spring returns that were abnormally inflated because of underwithholding of income taxes during 1990 and thus larger payments in April of 1991 and a decline to more normal payments and refunds in April of 1992.

Percentage Change In Total State Tax Revenue, Second Quarter 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arizona	-10.5%	18	Wyoming	4.6%	36	Montana	8.4%
2	Maryland	-2.8	19	Idaho	4.7		**United States**	**8.9**
3	Louisiana	-1.7	20	Oregon	4.8	37	Maine*	9.3
4	Massachusetts**	-0.4	21	Vermont*	4.9	38	Delaware	9.9
5	Oklahoma	-0.1	22	Mississippi	5.1	39	New York	10.7
5	Missouri	0.4	23	Colorado	5.7	40	Nevada	11.5
7	Pennsylvania*	0.7	24	Hawaii	5.9	41	North Dakota	12.0
8	Virginia	1.0	25	South Dakota	5.9	42	California*	12.6
9	Kentucky	1.3	26	Nebraska	6.0	43	Arkansas*	14.1
10	Ohio	1.9	27	Washington	6.0	44	Florida	14.2
11	Michigan	2.3	28	Illinois	6.1	45	New Mexico	15.9
	U.S. w/o change	**2.6**	29	Wisconsin	6.1	46	North Carolina*	19.7
12	South Carolina	2.7	30	Tennessee*	6.3	47	Connecticut*	26.2
13	Iowa	3.5	31	New Jersey*	6.5	48	Rhode Island*	32.0
14	Indiana	3.7	32	New Hampshire	6.8	49	Texas*	40.1
15	West Virginia	3.8	33	Minnesota*	7.5	50	Alaska	n.a.
16	Georgia	4.1	34	Alabama	7.9			
17	Kansas	4.2	35	Utah	8.1			

* Reflects legislated tax increase. ** Reflects legislated tax cut.

Even with these explanations, it would have been difficult for state estimates to predict the results shown in the table based upon economic forecasting tools alone.

Improving Revenue Forecasting

Practically all states base their revenue forecasts on economic models, statistical depictions presumably reflective of what causes changes in national and state economies. But the accuracy of these models, never a sure thing, is the subject of increasing doubt. In mid-October, Alan Greenspan, the chairman of the Federal Reserve who made a private career in economic forecasting, told the press: "No models can explain the types of patterns we are having. This is really a quite extraordinarily difficult type of environment."

State estimators are, as usual, being criticized heavily in the states where fiscal plans are being disrupted by abrupt changes in estimates. For example, **Maryland** substantially revised state and local finances this year with new state and local option taxes, but then had to consider cutbacks to reflect lowered revenue expectations. A major county executive summarized the concerns of many state and local officials:

> *We are now 22 days into the new fiscal year after taxes have been adopted and {we are} talking about massive cuts. One of the major areas that simply must be revised is the entire revenue-estimate approach.*

The long-time state comptroller, who makes the estimates, responded: "These are the most unusual times I've seen in state government in my time."

At the NCSL meeting this summer, the Council of State Governments presented the results of a survey of state revenue estimating practices. The survey covered what agency does the estimates, what outside forecasting groups and other state offices are involved, and what techniques are used. The Council concluded that states are moving toward more sophisticated forecasting techniques, consensus procedures involving legislative and executive branch estimators, and use of long-range forecasts. But the report is silent on two topics: (1) whether the accuracy of revenue estimates has been improved as a result of the changes and (2) what changes or practices are appropriate for adoption by all states.

Commenting on the study, **Reports** editor Hal Hovey counseled legislators on techniques for dealing with estimators, such as requiring them to specify their assumptions, trace their errors, and relate the assumptions used for forecasting revenue to those used to forecast spending. However, he said there was no evidence that any state had found a clearly superior way to estimate revenues. He recommended that state officials recognize that revenue estimating error is inevitable and hedge against errors by such devices as rainy day funds, leaving some spending contingent on revenue availability, and avoiding turning one year's unexpected revenues into the next year's permanent level of operating costs.

The Revenue Outlook

At their September meeting, the National Association of Business Economists released a poll of 49 forecasters who predicted that gross domestic product would increase by 1.8% in 1992, down from 2% predicted in May. These forecasters have also revised their estimate for 1993 from 2.7% to 3%. The Blue Chip Indicators consensus estimate also dropped to 1.8%, down from 2.1% estimated in July. These forecast revisions are likely to be tracked closely by revisions in state revenue estimates. This would imply that most states will see downward revisions of the economic forecasts underlying their FY 1993 budgets.

Expectations Of Tax Increases

The public believes that tax increases are likely, regardless of what is being said in campaigns. At the state level, the closest parallel to the campaigns of 1992 is the campaigns of 1982. At both times, state budgets were in poor shape because of recession. At both times, many states avoided decisive action to cut spending or raise taxes before the election. In both cases, candidates for the legislature and governor made no-new-tax pledges or came close to doing so. In December of 1982, special sessions raised state taxes in five states. Many of the states with gubernatorial elections in 1982 raised taxes in 1983.

There are no polls on the expectations for state tax increases, but polls on national policy may be a proxy. In a recent Harris Poll (Business Week, 10/19), from 60% to 70% of voters think their taxes will go up regardless of who is elected president. While the candidates are taking positions ranging from stressing opposition to higher taxes (President Bush) to promising higher taxes (Ross Perot), there is little difference in the public's perception of the likelihood of tax increases if different candidates are elected: 67% if Perot is elected, 64% if Clinton is elected, and 61% if Bush is elected. The same poll shows, as most polls do, less resistance to taxes on high income individuals and on alcoholic beverages and tobacco than to a national sales tax, higher federal income taxes, or higher gasoline taxes, which received the fewest favorable mentions by those polled.

MISCELLANY

Budget Cutting And The Courts

Tight budgets are producing many examples of litigation preventing or delaying cuts. In **New Jersey**, layoffs were delayed by an injunction. While the injunction was lifted, the issue is still in court. In **California**, the courts ordered the state to continue to pay Medicaid bills even though there was no valid state appropriation out of which to pay them.

A **Michigan** case typifies similar situations in many states. The closing of the Lafayette Clinic, a mental health facility, is controversial. The governor wants it closed for patient care, continuing only with some research functions. Enough legislators want it open so they appropriated funds in the FY 1993 budget for its operation. The governor vetoed the appropriation and the legislature didn't override. So at the beginning of Michigan's October 1 fiscal year there was no appropriation. On October 1, a state lower court judge ordered that the facility remain open and ordered the mental health commissioner jailed for contempt of court if he failed to continue to operate it for the 39 remaining patients, presumably using all the 250 remaining staff members. The governor wasn't happy:

> *Judge Hathaway is far out of bounds. It was very poor judgment, a very political judgment and unjudicious behavior.*

There may never be a clean legal resolution of this case, and others like it in other states, because of compromises in both the legal and political processes. When Michigan appealed the case, it agreed to keep the facility going with FY 1992 money while it lasted. The appeals court overturned the order for incarceration of the mental health director. The Senate passed legislation restoring a small appropriation for research operations, but rejected another appropriation for operations by votes of 16-19 and 18-19.

California's Problems

In an October hearing before a **California** Senate Committee, fiscal expert Steven Gold addressed what differentiates the state's fiscal circumstances from the other 49 states. His points, similar to the analysis in Issue 18, lay California's problems on three doorsteps:

- Demographics, particularly a 3.5% annual increase in school enrollment compared with 1.5% nationally.
- Economics, growth outdistanced by sub-par national performance.
- Fiscal Policy, particularly restraint in increasing taxes in the 1980s and limit measures (e.g., Proposition 13 affecting property taxes and the Gann Amendment affecting state taxes).

Gold disputed Governor Wilson's assertion that California has a "Cadillac system of government services." Gold finds pupil teacher ratios second highest in the nation, below-average college tuition and above-average welfare payments before, but not after, adjustments for cost of living differences. He also finds California to be one of the most generous Medicaid spenders, but doubts that the state should cut its services. Higher public sector salaries increase California costs, but Gold asserts that the test is the relationship between private and public salaries in California, not comparing California public salaries to those in other states.

Gold told committee members that Proposition 165's cuts in AFDC benefits differed from the emphasis in other states on welfare cuts affecting 100% state and local general assistance programs. He suggested that the state adopt "more positive, humane approaches to California's fiscal problems than an assault on poor children." He argues that AFDC isn't the main cause of California problems, that cost of living differences mean AFDC benefits aren't as generous as they appear, and that increases in AFDC caseloads are caused by recession and "once it ends, AFDC rolls will tend to decrease."

Brian Roherty, the executive director of the National Association of State Budget Officers, suggests in NASBO News (Sept.) that Californians are "not alone out there anymore." He emphasizes problems common to California and other states — need for dealing with federal issues ("a fiscal tidal wave heading for the states during 1993") and looking for "multiple and hard fought solutions rather than an old fashioned miracle."

Charter Schools

Governor Florio extended the debate over "charter schools" to **New Jersey** with a recent proposal that a maximum of two such schools be permitted in each of the state's 21 counties. Charter schools are already authorized under **Minnesota** law, with one school already in operation and three more, out of a maximum of eight authorized, scheduled to open next year. Under **California**'s plan, up to 100 such schools may be established. The concept, inherently vague at the outset, is to allow individual schools to escape the bureaucracy associated with school districts by, in effect, receiving a separate charter from the state giving them the flexibility associated with private schools. National Education Association affiliates have opposed the concept, saying it diverts attention from improving all schools.

Earmarking Tobacco Taxes

Health-oriented groups are pushing proposals for large increases in the cigarette tax (typically 25 cents a pack) with new revenues earmarked for anti-smoking programs and health spending arguably related to smoking. Such a measure was adopted by initiative in **California** and is on the November ballot in **Massachusetts**, where opponents have raised at least $6 million to try to defeat it.

As proponents concede, the measures incorporate two apparently inconsistent objectives. On the one hand, a major rationale for the tax increase is to discourage smoking. If successful, this would mean reducing state general revenues from existing cigarette tax rates as well as cutting the potential revenue for new health programs. On the other hand, the increases are supposed to pay for whatever increases in health spending they are designed to finance.

This fall, Governor Casey called the **Pennsylvania** legislature into special session to adopt a plan for youth health care to be funded from two cents of the cigarette tax that is already being collected. Versions of the plan are encountering two concerns in the legislature: (1) making available a 100% state-funded program that may draw some clients otherwise eligible for Medicaid with federal cost sharing, and (2) committing the state to providing health care to about 100,000 children. The fear is that the cost of the commitment will escalate while the yield of the tax will drop.

Economic Performance of the States

Comparing Individual States: Indicators of state economic performance continue to show many smaller Western states outperforming the nation by wide margins while Northeastern states and California have the most serious economic problems. The table shows the states that deviated more than 1.5% from the national one-year employment change.

Growth In Non-Agricultural Employment, July 1991 to July 1992

Rank	State	Percent	Rank	State	Percent
1	Idaho	3.4%	43	California	-2.1%
2	South Dakota	2.6	44	New Hampshire	-2.9
3	Arkansas	2.5	45	Maryland	-2.9
4	Utah	2.5	46	New Jersey	-3.1
5	North Dakota	2.1	47	New York	-3.2
5	Nevada	2.0	48	Massachusetts	-3.2
6	Montana	2.0	49	Connecticut	-3.8
	United States	**-0.5**	50	Rhode Island	-3.8

Retail trade growth shown by comparing the first seven months of this year with the first seven last year shows similar regional patterns. The strongest sales growth appeared in the states not bordering Oceans. Among what are called geographic divisions, the winners were the West and East South Central areas, together extending from Texas east and north to Kentucky and Alabama, with sales growth over 11%. Lagging the U.S. average of 4.7% growth: New England (1.2%), East North Central (1.9% for Wisconsin, Michigan and the three industrial states on their Southern borders), Pacific (2.3% in the region dominated by California), and South Atlantic (3.6% for Delaware south through Florida).

Building permits issued through July increased 16% over the same period last year. The largest gains were in resource-oriented states — over 40% in **Colorado**, **Idaho**, **Louisiana**, **Montana**, **Utah**, and **Wyoming**. Only three states showed significant drops in this indicator: **California** (-11%), **Nevada** (-20%), and **Hawaii** (-30%).

National Economy Sluggish: While some states are doing significantly better than others, no state is doing as well as many states did in past recoveries from recession. In its Pocket Chartroom (Sept./Oct./92), Goldman Sachs tabulated the growth in gross domestic product in the current recovery period and the five previous ones. From the second quarter of 1991 to the second quarter of 1992, growth was under 4%. In the five earlier recoveries, going back to the early 1960s, every first year of recovery saw 11% or better growth.

Federal Debt And State Budgets

In NASBO News (Sept.), the executive director of the National Association of State Budget Officers compares the current federal deficit (using $400 billion) with the smaller total of state general fund budgets (using $300 billion). In a recent state forum, Tom Triplett (Minnesota Business Partnership) followed the same approach for an individual state. He applied Minnesota's 2% share of national totals (e.g., population, gross state product) to calculate its share of the deficit. He then compared that share with the state's spending. Calculating state shares of the federal deficit yields the big numbers shown in the table, which can be contrasted with whatever state numbers readers consider appropriate (see Technical Notes for methodology).

Annual State Share Of Federal Deficit With Current Federal Spending And Taxes
($ millions)

State	Amount	State	Amount	State	Amount
California	$39,584	Tennessee	$6,454	Utah	$2,306
New York	23,529	Maryland	6,332	Nebraska	2,076
Texas	22,605	Minnesota	5,775	New Mexico	2,017
Florida	17,299	Louisiana	5,540	Nevada	1,673
Pennsylvania	15,585	Alabama	5,328	Maine	1,609
Illinois	15,040	Arizona	4,886	Hawaii	1,479
Ohio	14,253	Kentucky	4,838	New Hampshire	1,440
Michigan	12,206	South Carolina	4,639	Idaho	1,354
New Jersey	10,111	Colorado	4,400	Rhode Island	1,308
North Carolina	8,778	Connecticut	4,288	Montana	1,0[illegible]3
Georgia	8,629	Oklahoma	4,137	South Dakota	916
Virginia	8,190	Oregon	3,807	Delaware	886
Massachusetts	7,812	Iowa	3,642	North Dakota	827
Indiana	7,310	Mississippi	3,377	Alaska	743
Missouri	6,721	Kansas	3,251	Vermont	739
Washington	6,538	Arkansas	3,091	Wyoming	599
Wisconsin	6,456	West Virginia	2,347		

Because states were assumed to share in the federal deficit in proportion to population, the relative position of the states in the table simply replicates their relative populations.

Health Care Financing

Health Cost Overruns Continue: The pace of health care financing problems, described in detail in Issue 19, continues. Cost overruns in **Medicaid** are common, although few have yet reached public and legislative attention. The development of alternatives for cutbacks to stay within current appropriations is a public process in **Arkansas** and **Nebraska**, where the topic is one subject of a special legislative session. Departing Governor Gardner has **Washington** staff members working on cutback alternatives including dropping optional services, cutting back the program for the Medically indigent, and reducing state health care (but not Medicaid) costs by shifting some 100% state-funded activities to Medicaid.

New Universal Care Plan Proposed: The most dramatic recent proposal for near-universal health care was recently made by **Kentucky**'s governor. Prospects are uncertain in a legislature concerned over the program's cost and potential effects on economic development. Faced with these problems, the governor dropped his idea of a special session this year. Instead, an actuary will review cost estimates and the governor will seek consideration of his plan by the legislature next year.

New Plan For Children's Health Debated: In an October special session, **Pennsylvania** legislators are working on a non-Medicaid children's' health program using proceeds from two cents of the cigarette tax. The governor's original plan was oriented to children under six, but has been modified in discussions with legislators to target children under 20 in families with moderate and low incomes. The plan would extend to families at 300% of the poverty level (about $42,000 for a family of four), but the families themselves would pay a large share of the costs.

While considering the governor's plan, many Keystone State legislators are seeking to use the state's procedures for review of administrative rule making to block cutbacks in Medicaid coverage for general assistance recipients. The cuts underlie the appropriations level adopted in the legislative session earlier this year.

Provider Taxes: The states have been adopting health care provider taxes quietly — convincing the media that adjustments in past donation programs and compliance with federal guidelines, not new taxes, are the issue. With providers cooperating in return for higher reimbursement rates, the taxes have gone largely unnoticed.

This wasn't an option in **Oklahoma** because of a state requirement that tax increases be submitted to the voters. So the $90 million in taxes on hospitals, nursing homes, and drugs is on the November ballot. Some health care providers, particularly those who don't receive substantial Medicaid funds, are fighting the tax. The Department of Human Services has already announced cutbacks that would take place if the tax is not approved.

Taxing Wages Of Casual Workers

State income taxes and similar municipal taxes in Cleveland, New York, and Philadelphia are clearly applicable to income earned in a jurisdiction by non-residents. This means that consultants, professional athletes, entertainers, and traveling construction workers have tax liability to many jurisdictions.

Generally, the tax liability of the individual involved is little affected by the issue. For example, professional football players are likely to be paying tax on their entire incomes. Putting part of the tax where they play away games would reduce tax liability in the home state, but the home state would recover by taxing visiting teams. Because state and local taxes in one jurisdiction are generally creditable against taxes in others, many of the differentials in tax rates would also be washed out.

Individual jurisdictions aren't always indifferent to the adjustments as indicated by recent efforts by Philadelphia to collect its wage taxes from day nurses, lawyers, and athletes whose professions may bring them to the city for limited periods of employment. Philadelphia, as part of its efforts to reduce persistent fiscal problems, has recently initiated collection efforts against over 6,000 lawyers, accountants, and athletes.

Workers' Compensation

The **Pennsylvania** legislature went into special session in October to deal with Workers' Compensation reform as well as health care for children. The basic WC issues are the same as in other states. They are particularly salient in Pennsylvania because the proposed rate increase, 52%, is higher than elsewhere. The business-backed legislation seeks to control benefit amounts and limit eligibility. The governor has said he would veto it. His proposal is to limit medical costs by capping doctors' fees and to increase competition among insurance providers.

The state has a unique system because the Pennsylvania Manufacturers' Association is itself one of the insurers. The head of the state AFL-CIO calls a system where manufacturers are both the sellers and buyers of WC coverage "all smoke and mirrors."

Ironically, while **Pennsylvania** legislators were considering changing the employer-managed system as a reform, **Maine** legislators, also in special session, were considering setting up an employers' mutual insurance company as a reform.

In early October, legislators in **Maine** reached agreement on their Workers' Compensation reform plan. The plan is expected to save employers from 12% to 14% in premiums, primarily by substantial benefit reductions including a drop in the maximum weekly benefit from $536 to $441 and reducing the duration of permanent partial disability benefits from ten years to five. Under pressure of threatened withdrawal of private insurers from the state, the legislature adopted a new administrative apparatus for WC and authorized an employers' mutual company to provide competition to the private carriers.

There are roughly similar issues in **California**, where Governor Wilson recently vetoed several WC measures and announced his own proposals. They are designed to cut employer costs by eliminating certain benefits (e.g., stress claims), seeking to cap medical costs by managed care, and avoiding the immediate benefit increases found in the measures adopted by the legislature. Majority leaders (D) in the legislature have objected to the governor's call of an October special session on the grounds that they have already acted on WC reform.

TECHNICAL NOTES

Competing For Jobs: The Inc. 500 companies, which appear in the magazine's October issue, are related to 1991 population estimates in the table.

States And The International Economy: For more information see State And Local Governments In The International Arena (Advisory Commission on Intergovernmental Relations, Washington, DC 20575), States In The International Arena (special issue of The Journal Of State Government, Council of State Governments, Iron Works Pike, P.O. Box 11910, Lexington, KY 40578), and Competition Across The Atlantic: The States Face EC '92, (National Conference of State Legislatures, 1560 Broadway, Denver, CO 80202).

Poverty: Three recent Census Bureau reports provide considerable detail on the characteristics of the poverty population and the impact of government assistance on their living levels: Poverty In The United States: 1991, Measuring The Effect Of Benefits And Taxes On Income And Poverty: 1979 to 1991, and Money Income Of Households, Families, and Persons In the United States: 1991. None of these reports contains details of poverty populations in each state.

Tax Increases And Automatic Revenue Growth: Gold's calculations appear in the New York Times (10/4 with a correction for Ohio on 10/11). The start year, 1979, was chosen as Governor Clinton's first year. The end year, 1990, is the last year with Census data available. The FY 1990 burdens and state rankings are Table D-1 in States In Profile. The tax burden computation excludes other sources of revenue such as federal aid, fees, and interest earnings. Gold expresses changes as a percentage of a percentage. For example, the Texas burden grew from 9.43% of income to 10.71% of income. The burden grew by 1.28% of income (not shown) or by 13.6% (12.24 times 100 divided by 11.92).

The statistics on growth in personal income and total tax revenues come from State Revenue Reports (August, Center for the Study of the States, Rockefeller Institute of Government, 411 State St., Albany, NY 12203).

Federal Debt: The calculation uses 1991 population estimates of the Census Bureau which total 251,583 for the 50 states. Purists can add the District of Columbia, territories and possessions in any combination they think appropriate. The calculation uses the federal deficit being incurred in the second quarter of 1992 expressed at an annual rate, or $327.8 annually. The federal budget concept is that of the national income accounts. Using other concepts (e.g., federal budget basis, with or without certain transactions such as bank bailouts) or other time periods will produce somewhat different numbers for deficits. Readers can adjust the table for their concept of what the federal deficit is by multiplication by a fraction with their deficit the numerator and $327.8 as the denominator.

The per capita federal *deficit* calculated by the method above is $1,303. With the deficit running at nearly $1 billion per day, the federal *debt* is a rapidly changing number. There are different concepts of debt (e.g., including or excluding debt not held by the public such as debt held by trust funds). Multiplying the deficit numbers by 10 to get debt is a reasonable approximation, making the debt about $13,000 per capita. On October 1, federal debt held by the public was about $3.0 trillion and total federal debt was about $4.5 trillion.

Health Care Financing: The discussion of health care financing is taking place in an atmosphere of increasing uncertainty about federal regulations affecting provider taxes which may be issued after the November elections and about further litigation over whether existing state indigent care programs are preempted by federal (ERISA) legislation.

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